

## PART II

## CHAPTER 4. CONDUCTING INITIAL SCREENING OF POTENTIAL BORROWERS

4-1. INTRODUCTION. One of the first steps in processing a Section 312 Rehabilitation Loan is the initial screening of potential borrowers. The initial screening process outlined in this Chapter is designed so that it can be used concurrently for other rehabilitation programs in the locality. It is intended to help local officials quickly make a preliminary determination as to whether or not the prospective borrower appears to qualify for the Section 312 program, or whether he or she would be better suited to any of the locality's other rehabilitation programs, such as CDBG-funded rehabilitation grants (if available in the locality and if consistent with CDBG statutory and regulatory requirements). This preliminary screening is essential for the cost-effective administration of rehabilitation programs; it helps to minimize the staff time spent on ineligible applicants or projects.

For prospective borrowers who are owner-occupants of one-to-four unit properties, Local Processing Agencies should gather information for this screening at an initial interview with the potential borrower(s). When gathering the necessary information at the initial screening interview, LPA's should use the Application for Section 312 Rehabilitation Loans for Owner-Occupants of 1-4 Unit Properties (HUD Form 6230, Exhibit 4-1 in this Handbook), since it is required when completing the final application process. If LPA's use the application, Exhibit 4-1, during the initial screening, they will obtain much of the information needed for the final application, and if applicable, will avoid the need to obtain duplicate information later in the application process. If they prefer, LPA's may use some other checklist designed by the LPA to assist in gathering the necessary information at the initial screening interview.

For prospective borrowers who are investor-owners of single-family, multifamily, non-residential or mixed-use properties, the Application for Section 312 Rehabilitation Loans for Investor Properties (HUD Form 6243, Exhibit 4-2 in this Handbook) is required. LPA's should give this application to these applicants and request that they complete as much of the form as possible prior to the interview since the necessary information is so complex and time-consuming to prepare.

For all potential Section 312 applicants, LPA's should also use the initial interview to explain the locality's rehabilitation programs, including the Section 312 program. If the prospective borrower appears to qualify for a Section 312 Loan, LPA' must describe the Section 312 program (see Chapters 2 and 3), and must review HUD's requirements for repayment of, and security for, loans (detailed in the legal documents) with the potential borrower. (See Paragraph 9-3 for a listing of these

legal documents.) The LPA must also emphasize that the rehabilitation contracts between the borrower and any contractor, subcontractor, or supplier are the borrower's responsibility and that HUD assumes no legal responsibility to the borrower for the quality of the rehabilitation work performed or the materials supplied. (See Paragraph 6-1 of this Handbook.)

The Rent Regulatory Agreement must also be discussed with investor-owners of multifamily properties at the initial interview. (See Paragraph 9-2-c of this Handbook for additional information on the Rent Regulatory Agreement.)

An initial determination of programmatic eligibility for a particular Section 312 Loan is based on the following criteria, each of which is detailed in the following Paragraphs of this Chapter:

- a. Location of the Property. Is the property located in an eligible target area? (See Paragraph 4-2 of this Handbook.)
- b. Type of Property. Is the property an eligible single-family, multifamily, mixed-use, or non-residential property? (See Paragraph 4-3 of this Handbook.)
- c. Type of Borrower. Do the individuals in question own the property in their own name, or is the property held by a corporation or partnership with legal capacity to receive and expend the loan proceeds for the work proposed? (See Paragraph 4-4 of this Handbook.)
- d. Improvements Desired by Borrower. Does the property have deficiencies in Local Rehabilitation Standards? Are the other improvements desired by the prospective borrower eligible under the Section 312 program? (See Paragraph 4-5 of this Handbook.)
- e. Family Income. For owner-occupants, are they within the low- and moderate-income statutory priority? If not, is there some other justification for the loan? Do they qualify for a three percent rehabilitation loan or would they be required to pay the higher government securities rate? For investor-owners, do the tenants fall within the low- and moderate-income requirements, or is the property in an eligible low- and moderate-income neighborhood? (See Paragraph 4-6 of this Handbook.)
- f. Ability to Repay a Loan. Based on an initial assessment of household income and other monthly liabilities for owner-occupants, or an assessment of projected rental income and operating expenses for investor-owners, does the borrower have the capacity to repay the rehabilitation loan? Would the prospective borrower be a better candidate for one of the other rehabilitation programs administered

4-7 of this Handbook.)

Each of these considerations is discussed in the following Paragraphs of this Chapter.

- 4-2. DETERMINING IF PROPERTY IS IN AN ELIGIBLE AREA. Properties in one or more of the following areas are the only ones which are eligible for Section 312 financing:
- a. CDBG or UDAG Areas: Properties whose rehabilitation is part of, or is necessary or appropriate to the execution of, CDBG or UDAG activity (See Chapter 1 for a definition of CDBG and UDAG.)
  - b. Urban Homestead Areas: Properties in an Urban Homestead Area (See Chapter 1 for a definition of Urban Homestead Area.)
- 4-3. CLASSIFYING ELIGIBLE PROPERTIES. Section 312 Rehabilitation Loans may only be made for properties that have one or more deficiencies in Local Rehabilitation Standards. (See Chapter 1 for a definition of Local Rehabilitation Standards.) If the property does have one or more such deficiencies, other work can also be done on the property if the items are eligible in accordance with Chapter 3.

The following types of properties are eligible for the Section 312 Rehabilitation Loan program:

- a. Single-Family Properties
  - (1) General. Property with one-to-four dwelling units after rehabilitation and no non-residential used after rehabilitation is classified as single-family property under the Section 312 Program.
  - (2) Owner-Occupied vs. Investor-Owned Property. If the owner of a one-to-four unit property occupies one of the units in that property as his or her principal residence, that property is considered owner-occupied. If not, it is considered investor-owned. For owner-occupants of single-family properties, the application in Exhibit 4-1 must be used. For investor-owners of single-family properties, the application in Exhibit 4-2 must be used and their loans must be underwritten like multifamily and all other loans to investor-owners in accordance with Paragraph 7-6 of this Handbook. Investor-owners of single-family properties are not eligible for three percent (3%) loans.
  - (3) Manufactured and Modular Homes. Manufactured homes, double-width homes and modular homes are eligible for Section

312 Loans if they meet all of the following requirements: (a) the home must be permanently installed and have permanent utility hook-ups, (b) the prospective borrower must own the land, have a lease for at least the term of the Section 312

Loan, or otherwise have the unconditional right, for the term of the loan, to keep the home on the site on which it was located when the loan was made, and (c) it must be possible to obtain a security interest on the dwelling as real property under state and local law.

b. Multifamily Properties

- (1) Definition of Multifamily Properties. Multifamily properties include all residential properties with five or more dwelling units after rehabilitation.
- (2) Approval by HUD. All Section 312 Loans for multifamily properties must be submitted to the HUD Field Office Rehabilitation Management Specialist for final approval, whether or not the locality has Loan Approval Authority. As such, the Approving Officer for multifamily loans must be a HUD official. (All Section 312 multifamily loans exceeding \$200,000 must be submitted to the HUD Field Office Director of Community Planning and Development and to the Director of Urban Rehabilitation in HUD Headquarters for final approval, in accordance with the requirements detailed in Paragraph 7-4 of this Handbook.)
- (3) Maximum Number of Units. In addition to the other requirements in this Handbook, Section 312 Rehabilitation Loans can only be made on multifamily properties having ninety-nine or fewer dwelling units.
- (4) Income Requirements. The prospective residents must meet certain income limits, or the property must be located in a neighborhood meeting certain income qualifications, as detailed in Paragraph 4-6-e of this Handbook.
- (5) Application Requirements. The application in Exhibit 4-2 is required for all multifamily loans.
- (6) Underwriting Requirements. All loans on multifamily properties must be underwritten as loans to investor-owners pursuant to Paragraph 7-6 of this Handbook.
- (7) Rent Regulatory Agreement. Borrowers for all multifamily properties must comply with the requirements concerning the Rent Regulatory Agreement, detailed in Paragraph 9-2-c of this Handbook.

8/13/86

4-4

---

7375.01 REV-2

- c. Mixed-Use Properties. Mixed-use properties, as defined in Chapter 1, are eligible types of properties. Borrowers for mixed-use properties are not eligible for three percent (3%) Section 312 Loans for any portion of their mixed-used project, and must comply with the requirements of Paragraph 2-3-b of this Handbook concerning interest rates. In addition, borrowers for mixed-use properties containing five or more dwelling units after

rehabilitation must comply with the requirements of Paragraphs 4-3-b-(2) through 4-3-b-(7) concerning HUD approval, maximum number of units, Rent Regulatory Agreement, income limits and application requirements. All portions of mixed-use properties must be underwritten as investor-owned properties, as detailed in Paragraph 7-6 of this Handbook. (See Paragraph 7-6-a-(2)-(a)-1 of this Handbook concerning the underwriting of loans to investor-owners who occupy a portion of the property themselves for residential or non-residential use.)

- d. Non-Residential Properties. A property containing no dwelling units is eligible as non-residential property, so long as it is not a church or other structure to be used to promote religious interests. Borrowers for non-residential properties are not eligible for three percent (3%) Section 312 Loans, and must comply with the requirements of Paragraph 2-3-b of this Handbook concerning interest rates and the requirements of Paragraphs 4-3-b-(2) through 4-3-b-(5) of this Handbook concerning HUD approval and application requirements. Non-residential properties must be underwritten as investor-owned properties, as detailed in Paragraph 7-6 of this Handbook. (See Paragraph 7-6-a-(2)-(a)-1 of this Handbook concerning the underwriting of loans to investor-owners who occupy a portion of the property themselves for residential or non-residential use.)
- e. Congregate Housing Properties and Single-Room Occupancy Properties. Congregate housing properties and single-room occupancy properties, as defined in Chapter 1, are eligible types of properties. Borrowers for congregate housing and single-room occupancy properties are not eligible for three percent (3%) Section 312 Loans, and must comply with the requirements of Paragraph 2-3-b of this Handbook concerning interest rates. All congregate housing and single-room occupancy properties must meet the requirements detailed in Paragraphs 4-3-b-(2) through 4-3-b-(6) of this Handbook concerning multifamily properties regardless of the number of dwelling units, and they must be underwritten as investor-owned properties, as detailed in Paragraph 7-6 of this Handbook. In addition, borrowers for congregate and single-room occupancy properties with five or more dwelling units after rehabilitation must comply with the requirements concerning the Rent Regulatory Agreement detailed in Paragraph 9-2-c of this Handbook.
- f. Cooperative Properties. Cooperative properties are eligible types of properties. Cooperatives meeting the requirements of Paragraph 2-3-a-(2) of this Handbook are eligible for three percent (3%) Section

312 Loans, but all other cooperatives must comply with the requirements of Paragraph 2-3-b of this Handbook concerning interest rates. All cooperative properties must also meet the requirements detailed in Paragraphs 4-3-b-(2) through 4-3-b-(6) of this Handbook concerning multifamily properties regardless of the

number of dwelling units, and they must be underwritten as investor-owned properties, as detailed in Paragraph 7-6 of this Handbook.

4-4. DETERMINING IF THE PROSPECTIVE BORROWER IS AN ELIGIBLE TYPE OF BORROWER.

In order to receive a Section 312 Rehabilitation Loan, a borrower must qualify under one of the following categories:

a. Owners

- (1) Owner-Occupant. A prospective borrower whose principal residence is, or will be immediately following completion of work, a dwelling unit in a property with one-to-four units after rehabilitation which is owned by that prospective borrower, and which is the subject of the loan, is an eligible type of Section 312 borrower.
- (2) Investor-Owner. The following types of owners are classified as investor-owners and are eligible types of Section 312 borrowers:
  - (a) A prospective borrower who owns a one-to-four dwelling residential property but does not occupy a dwelling unit in that property as a principal residence;
  - (b) A borrower who owns a non-residential, mixed-use, single-room occupancy, congregate housing or multifamily property, regardless of whether he or she occupies a dwelling unit in that property as a principal residence;
  - (c) A corporation or partnership that owns the property in question and has the legal capacity to receive and expend the loan proceeds for the work proposed. For corporations, LPA's must ensure that the corporation has the legal capacity described in the previous sentence, and that any corporate resolutions needed to authorize the corporation to enter into debt are issued prior to settlement. For partnerships, LPA's must ensure that the partnership has the legal capacity to receive and expend the loan proceeds for the proposed work and that each general and limited partner understands that he or she is required to personally sign the note and mortgage and assume personal liability for the full amount of the loan. (See Paragraphs 5-2-c and 5-3-c of this Handbook for additional

8/13/86

4-6

---

7375.01 REV-2

requirements concerning verification of the legal capacity described in this Paragraph.)

- b. Land Contract Purchasers. The purchaser-occupant of a single-family property under a written installment land sales contract for the acquisition of title to the property may be a

borrower only if the owner(s)/seller(s) of the property subject their interest in the property to the Section 312 mortgage or deed of trust according to the legal procedure required by HUD in the jurisdiction.

- c. Contract Purchasers. Applications can be considered from prospective borrowers who have properties under purchase contracts if the purchase contract provides sufficient time for adequate review of the loan. However, the loan cannot be settled until valid legal title passes to the purchase/borrower and exists in the purchaser's/borrower's name.
- d. Urban Homesteaders. Urban Homesteaders who have executed a conditional conveyance and a homesteader agreement, which meets the requirements of 24 CFR Part 590, to acquire and rehabilitate an eligible property are eligible borrowers, provided that the locality and/or the LPA complies with the requirements concerning Urban Homestead borrowers set forth in Paragraph 12-16 of this Handbook.
- e. Cooperatives. The borrower must be the cooperative corporation or association, acting through its governing body. The borrower must submit an opinion from a qualified attorney-at-law, acceptable to the LPA counsel and the Approving Officer, that the governing body is authorized by State and local law and by the organizational documents of the cooperative to act in accordance with the application, and to agree to all the terms and conditions of the loan.

#### 4-5. DETERMINING IF IMPROVEMENTS DESIRED BY BORROWER ARE ELIGIBLE

- a. Correcting Deficiencies in Local Rehabilitation Standards. Section 312 Rehabilitation Loans may only be made for properties which have one or more deficiencies in Local Rehabilitation Standards. (See Chapter 1 for a definition of Local Rehabilitation Standards.) After rehabilitation, the property must, at a minimum, conform to the Local Rehabilitation Standards.
- b. Housing Assistance Plan Requirements. If a locality wants to have Section 312-assisted units meet housing assistance goals set forth in the locality's Housing Assistance Plan, the Section 312 units must meet the minimum requirements of the Housing Quality Standards (24 CFR 882.109) after rehabilitation.
- c. Other Eligible Improvements. Within the limitations on the loan amount (detailed in Chapter 2), a Section 312 Rehabilitation Loan may

also include amounts for eligible purposes other than meeting the Local Rehabilitation Standards, including general property improvements (GPI's). (See Chapter 3 for a detailed discussion of eligible costs.)

4-6. DETERMINING IF THE SECTION 312 PROGRAM'S INCOME REQUIREMENTS ARE MET

- a. General Requirements. In processing Section 312 Rehabilitation Loans, the LPA must give priority to low- and moderate-income persons, which, for the purposes of this Paragraph, means persons whose income does not exceed ninety-five percent (95%) of the median income for the area. (See Chapter 1 for a definition of low- and moderate-income person.)
- b. Calculating Family Income. For the purposes of this Handbook, the family income of a prospective borrower or tenant must include the following, except as provided for in Paragraphs 4-6-c-(1) and 4-6-c-(2) of this Handbook:
  - (1) The earnings of the prospective borrower(s) or tenant(s), and of his or her spouse living in the same dwelling unit, and (for borrowers) of all adults who have an ownership interest in the property and will co-sign the Section 312 promissory note. For tenants, the earnings of any other adult living in the same dwelling unit must also be included.
  - (2) Other funds regularly contributed or paid by a person not having an ownership interest in the property to a person listed in Paragraph 4-6-b-(1). This includes funds regularly paid or contributed by other family members not living in the same dwelling unit or by other adults who live in the dwelling unit. These contributions or payments must be verifiable, stable and likely to continue if they are to be included as income under this section. (See Paragraph 5-5 of this Handbook for additional information about verifying income, and Paragraph 7-5-a-(2) of this Handbook for requirements on determining whether the income, payments or contributions may be considered stable and likely to continue.)
  - (3) Income from alimony, child support, separation maintenance payments or public assistance which is likely to be consistently received by the borrower(s). Income from these sources must be included as family income when determining if the borrower qualifies for a three percent (3%) loan in accordance with Paragraph 2-3-a of this Handbook. (See Paragraph 5-5 of this Handbook for additional information about verifying income, and Paragraph 7-5-a-(2) of this Handbook for requirements on determining whether the income, payments or contributions may be considered stable and likely to continue.)

8/13/86

4-8

---

7375.01 REV-2

- (4) Cash flow from real estate, other than the property to be rehabilitated.
- (5) Net income from any rental units in the property to be rehabilitated, based on the following:

- (a) Gross rental income; minus
  - (b) the pro rata share of expenditures for the mortgage principal and interest, mortgage insurance premiums, risk premiums, service charges, hazard insurance premiums, real estate taxes and special assessments attributable to the rental units (which may be prorated on a square footage basis); minus
  - (c) the pro rata share of maintenance, repairs, heating and utilities, other cash expenditures and vacancies attributable to the rental units, as determined in accordance with underwriting requirements detailed in Paragraph 7-6-a of this Handbook (which may be prorated on a square footage basis).
- c. Income for Eligibility vs. Income for Underwriting Purposes. If funds are included as "stable monthly income" for the purposes of underwriting in accordance with Chapter 7, they must also be included for the purposes of determining the borrower's eligibility for a three percent (3%) Section 312 Loan in accordance with Paragraph 4-6-d of this Handbook with the following two exceptions:
- (1) Earnings of co-makers who will sign the promissory note but who do not have an ownership interest in the property may be included as "stable monthly income" for the purposes of underwriting even if this income is excluded from income for the purposes of determining a borrower's eligibility for a three percent (3%) loan. (Regular contributions from such co-makers to a person listed in Paragraph 4-6-b-(1) which meet the requirements of Paragraph 4-6-b-(2) must be included as income for both eligibility and underwriting.) See Paragraph 7-5-a-(2)-(b) for addition requirements concerning a co-maker's income.
  - (2) Income from alimony, child support, separation maintenance payments or public assistance need not be disclosed by the borrower for the purposes of underwriting, but must be included as income for the purposes of determining if it is likely to be consistently received.

- d. Setting Interest Rates. For prospective borrowers who are single-family owner-occupants who have incomes (as determined in accordance with Paragraph 4-6-b of this Handbook) not exceeding eighty percent (80%) of the median family income for the area, adjusted for family size, the interest rate on their loan would be three percent (3%). The interest rate for all prospective borrowers not eligible for a three percent (3%) loan must be set in accordance with the provisions of Paragraph 2-3-b of this Handbook.
- e. Requirements for Multifamily Properties. Multifamily properties

must meet the requirements of Paragraph 4-2 of this Handbook concerning eligible areas, and all other applicable requirements of this Chapter and Handbook, and either of the following two requirements:

- (1) the property must be located in a neighborhood identified by the locality in which the median income of persons and families residing therein does not exceed eighty percent (80%) of the median income for the area, as determined by HUD with adjustments for smaller and larger families, and based on data from the most recently available U.S. Census; or
- (2) at least fifty-one percent (51%) of the property's initial tenants after rehabilitation must have family incomes that do not exceed eighty percent (80%) 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.

#### 4-7. MAKING AN INITIAL DETERMINATION ABOUT A PROSPECTIVE APPLICANT'S ABILITY TO REPAY A SECTION 312 LOAN

- a. Overview. It is important to note that while the Section 312 program is primarily designed to assist low- and moderate-income persons, a borrower must also have sufficient income to be able to repay a Section 312 Loan. The final step in the initial screening process involves making an initial calculation of how much money the prospective borrower can afford to borrow for rehabilitation.

It is critical that LPA's carefully assess each prospective borrower's ability to repay a loan. This is necessary to help minimize the Federal government's losses under the Section 312 program and to help protect the prospective borrower's interests; LPA's must be careful not to encourage applicants to apply for loans that they cannot realistically afford to repay because, if the loan is approved, the borrower is likely to get behind in payments, default, blemish his or her credit record, and possibly lose his or her house in foreclosure proceedings. Under those circumstances, the property may well deteriorate again, defeating the entire purpose of the loan. (See Chapter 7 for details about loan underwriting.)

8/13/86

4-10

---

7375.01 REV-2

- b. Loans to Owner-Occupants of Single-Family Properties

- (1) Using Standard Underwriting Ratios. The first ratio compares monthly housing expense, including the cost of the rehabilitation loan, to gross monthly income; the second ratio compares the monthly cost of all long term debt, including all housing debt, to gross monthly income. It is important to note that, at this stage in the screening process, only an initial determination is made of the prospective borrower's ability to repay a rehabilitation

loan, which is based on unverified data supplied by the applicant. For additional information on underwriting and making a final decision about loans, see Chapter 7; for additional information about obtaining verifications, see Chapter 5.

- (2) Section 312 Underwriting Standards
  - (a) Total monthly housing expenses must not exceed twenty-eight percent (28%) of gross monthly income, and
  - (b) The monthly cost of all long term debt must not exceed thirty-six percent (36%) of gross monthly income.
- (3) Monthly Housing Expense. Monthly housing expense includes the following (and does not include utility and maintenance costs):
  - (a) monthly principal and interest payments, risk premium on the Section 312 Loan and other mortgage insurance premiums (when applicable) for all current and proposed debt secured by the property, including debt on the Section 312 Loan; and
  - (b) monthly payments for real estate taxes and hazard insurance.
- (4) Long Term Debt. Long term debt includes the following:
  - (a) Monthly housing expenses as described in Paragraph 4-7-b-(3) of this Handbook;
  - (b) payments on installment loan or revolving charge account debts with more than 10 remaining payments; and
  - (c) alimony, child support or maintenance payments.
- (5) Using Initial Determination of Affordability. At this point, the LPA's needs to make a judgement as to whether the prospective borrower appears to qualify for the Section 312 program. If the prospective borrower does not appear to be able

to afford any additional debt, or if the amount of money the applicant could afford to borrow appears significantly less than the applicant's estimated cost of rehabilitation, the prospective borrower must be rejected for Section 312 funds and, where appropriate, referred to other rehabilitation programs available in the locality.

If, on the other hand, this initial analysis of affordability indicates that the amount of rehabilitation loan the

prospective borrower can afford to borrow is in line with the cost of the improvements the applicant says he or she needs -- and if the other criteria in this Chapter are met and it appears likely that sufficient program funds will be available to make the loan in the foreseeable future -- the LPA may process the prospective borrower further.

c. Loans to Investor-Owners

- (1) General Requirements. For investor-owners, LPA's must determine if the rental income is sufficient to support the Section 312 Loan. LPA's must use the following standard to make an initial determination about an investor's ability to afford a Section 312 Loan: net operating income (calculated as gross income minus projected vacancies minus operating expenses other than debt service) must be at least 110% of total debt service.
- (2) Determining if the General Requirements Are Met. In making an initial determination about affordability for investors, LPA's may use the unverified information in the application (Exhibit 4-2), if available, or other information supplied by the prospective borrower. LPA's should determine if the prospective borrower's net operating income, excluding debt service, is at least 110% of debt service.
- (3) Making an Initial Determination about Affordability. LPA's should determine if the prospective borrower's proposed net operating income, multiplied by 1.1 is greater than the total debt service. If so, it can be assumed, at least at this point in the review process, that the applicant can afford the Section 312 Loan, and if it appears likely that sufficient program funds will be available to make the loan in the foreseeable future, the LPA may process the applicant further.