

## CHAPTER 1. GENERAL

- 1-1. INTRODUCTION. For a summary explanation of cooperatives, see reference (1) of the Foreword. Section 4(b) of The Emergency Home Purchase Assistance Act of 1974 added a new subsection (n) to Section 203 of the National Housing Act. Under this program, Section 203(n) mortgages are insured to assist individuals or families in acquiring stock certificates or membership certificates, hereafter referred to as Corporate Certificates, in cooperative housing projects which are covered by blanket mortgages insured under the National Housing Act. An individual or family which is already a stockholder or member of a cooperative housing project cannot obtain a mortgage encumbering his/her Corporate Certificate under this program. Likewise, the program is limited to owner-occupants. Non-occupant owners are not eligible.
- a. The 203(n) program is available to assist a purchaser in acquiring a Corporate Certificate, thereby assuming the responsibility for the monthly charges due the cooperative which are attributable to the dwelling unit the owner of the Corporate Certificate is entitled to occupy, and financing a portion of the seller's equity with an insured mortgage.
  - b. The seller's equity is the difference between the outstanding principal balance on the project mortgage attributable to the dwelling unit the owner of the Corporate Certificate is entitled to occupy and the fair market value of the dwelling unit, assuming it was being sold on the open market.
  - c. As in the other single-family mortgage insurance programs, the equity financing loan will be funded by a HUD approved mortgagee and the mortgage will be insured by the Department.
- 1-2. DEFINITIONS FOR USE IN THE 203(n) PROGRAM
- a. "Mortgage" shall mean a first lien given to secure a loan made to finance the purchase of a Corporate Certificate together with the applicable Occupancy

Certificate of a cooperative ownership housing corporation in which the permanent occupancy of the dwelling units is restricted to members of such corporation.

- b. "Corporation" shall mean an organization which holds title to a cooperative housing development for the member/owners which is covered by a blanket mortgage or mortgages insured under the National Housing Act, as amended.
  - c. "Corporate Certificate" shall mean such stock certificates, membership certificates, or other instruments which the laws of the jurisdiction in which the cooperative housing development is located require to evidence ownership of a specified interest in the corporation,
  - d. "Occupancy Certificate" shall mean a written instrument provided by the corporation to each member/owner holder of a Corporate Certificate which grants an exclusive right of possession of a specific dwelling unit in the cooperative housing development.
  - e. References to "Property." The term "property" in this Handbook, the regulations for Section 203(n) and other material dealing with the program shall be construed to mean the Corporate Certificate together with the rights conveyed by the Occupancy Certificate. Where such references when interpreted under Section 203(n) of the National Housing Act clearly indicate the intent to be the dwelling unit, such references shall mean the dwelling unit identified in the Occupancy Certificate.
- 1-3. REGULATIONS - Regulations governing the program are located in Chapter II of Title 24 of the Code of Federal Regulations under Section 203.43c and Section 203.437.
- 1-4. MAXIMUM MORTGAGE AMOUNT - The mortgage shall not exceed the amount calculated per instructions for Section 203(b) relating to owner-occupants minus the portion of the unpaid balance of the blanket mortgage which is attributable to the dwelling unit.

- (1-4) a. The following example is for clarification purposes:

HUD estimated value of dwelling unit	\$38,000
HUD estimated closing costs	500
Unpaid balance on project mortgage attributable to dwelling unit (as of the date of acceptance)	23,865

The maximum insurable mortgage amount would be \$13,200, calculated as follows:

HUD estimated value for mortgage insurance purposes (sum of value and estimated closing costs)	\$38,500
97% of \$25,000	\$24,250
95% over \$25,000	12,825
Maximum insurable under Section 203(b)	<u>\$37,075</u>
	\$37,075
	-23,865
Maximum insurable under Section 203(n)	<u>\$13,210</u>

\$13,210 rounded to the next lower multiple of \$50 is \$13,200. This is the method to be utilized in determining the maximum mortgage amount to be placed on the conditional commitment (see Chapter 2).

- b. The contract of sale can be drawn in such a manner that the outstanding balance on the project mortgage attributable to the Corporate Certificate may or may not be reflected in the sales price of the Corporate Certificate. For example, if HUD's estimated value of the dwelling unit is \$30,000 and the portion of the outstanding balance of the project mortgage attributable to the Corporate Certificate is \$20,000, the sales price of the Corporate Certificate set forth in the sales contract may be \$30,000, not the value of the Corporate Certificate, \$10,000. In such situations, the normal contingency clause relating to the financing should contain language to the effect that the portion of the outstanding balance on the project mortgage attributable to the Corporate Certificate,

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\$20,000 in this example, which is reflected in the sales price will not be paid in cash but that payment of this obligation will be assumed by the mortgagor at closing.

- c. Another situation which can occur is where the sales price is set forth as the value of this Corporate Certificate, \$10,000 in this example, and language is included that the purchaser is aware and acknowledges that a portion of the outstanding balance on the project mortgage is attributable to the dwelling unit which the purchaser will be entitled to occupy as the owner of the Corporate Certificate.
- d. The maximum mortgage amount which will be available

to the purchaser will be based on the mortgagor's Total Acquisition Cost, of the Corporate Certificate or the HUD estimate of the value of the dwelling unit plus the estimate of closing cost, whichever amount is lower, less the unpaid balance of the blanket mortgage covering the cooperative development which is attributable to the dwelling unit. See Chapter 3 of this Handbook for mortgage credit instructions on determining the maximum mortgage amount for the firm commitment.

- 1-5. MAXIMUM TERM AND AMORTIZATION PERIOD OF 203(n) LOANS - The maximum term is 30 years, the remaining term of the blanket mortgage covering the cooperative development or three-quarters of the remaining economic life of the building improvements encumbered by the blanket mortgage, whichever is the least. The Amortization period must be either 5, 10, 15, 20, 25 or 30 years.
- 1-6. SECTION OF THE ACT CODE - The section of the Act code for 203(n) mortgages is 260. For mortgages insured pursuant to Section 223(e) authority, the code is 360.
- 1-7. INTEREST RATE: Same as for Section 203(b).
- 1-8. SECURITY FOR THE LOAN - Mortgages insured under this program are given to finance the purchase of a Corporate Certificate and Occupancy Certificate in a cooperative housing project, the permanent occupancy of which is restricted to members of such

cooperative. The security for the loan is the Corporate Certificate and the Occupancy Certificate entitling the owner to the permanent occupancy of one of the dwelling units owned by the cooperative. The mortgagee must establish a first lien on the mortgagor's Corporate Certificate and Occupancy Certificate under the laws of the state where the cooperative housing development is located. (See paragraph 1-12.)

- 1-9. SECONDARY LIEN - The only other lien permitted on property, i.e., the Corporate Certificate and Occupancy Certificate, is the Cooperative's lien, which is a lien for cooperative fees, and it must be subordinated to the lien established by the 203(n) insured mortgage. Accordingly, the organizational documents of the cooperative corporation must provide that a mortgage insured

under Section 203(n) shall be a first lien upon the property covered by the mortgage.

1-10. TRI-PARTY AGREEMENT - The regulations require a Tri-Party Agreement between the corporate owner of the cooperative housing development, the 203(n) mortgagee, and the Secretary. The Agreement is intended to be a part of each origination of a mortgage covering an individual dwelling unit under Section 203(n). The Agreement obligates the signers to provide notices, acknowledge interests in, and perform functions regarding the dwelling unit and ownership documentation. This Agreement is necessary to carry out the regulatory requirements of the 203(n) program. The Agreement, which must be identical to the one set forth in Appendix 1, is an agreement which must accompany the submission for insurance endorsement. It must be reviewed by the Director of Housing or his/her designee, and if found acceptable, signed by the Director. The original should be inserted in the insured case binder with two copies to be sent to the 203(n) mortgagee with the executed Mortgage Insurance Certificate, Form FHA-9100.

- a. A sample Tri-Party Agreement is set forth in Appendix 1 of this Handbook. No modifications, additions, or deletions to the Agreement are permitted. The submission of an executed Tri-Party Agreement identical to the one set forth in Appendix 1 must be a condition

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for insurance set forth in each conditional commitment issued under Section 203(n).

- b. Cooperatives, mortgagees, and Field Office personnel shall review the terms and conditions set forth in the Tri-Party Agreement and familiarize themselves with the obligations that will be incurred upon execution of the Agreement.
- 1-11. APPLICATION FORMS AND REQUIRED DOCUMENTATION  
Applications for appraisal of the dwelling unit attributable to the Corporate Certificate and issuance of a conditional commitment to insure a mortgage encumbering the Corporate Certificate and Occupancy Certificate are submitted on Form FHA-2800, Application for Property Appraisal and Commitment. These applications must be transmitted by a covering letter containing the language set forth in the draft letter in Appendix 2. Lenders

should note the agreement they are committing themselves to when signing the covering letter.

- a. True copies of the following documentation are required to accompany the application form:
  - (1) Certificate of Incorporation.
  - (2) Regulatory Agreement and amendments.
  - (3) Bylaws as amended.
  - (4) Current Financial Statement.
  - (5) Proposed Occupancy Certificate.
  - (6) Proposed Corporate Certificate.
  - (7) A letter signed by the mortgagee identical to the format letter set forth in Appendix 2.
  - (8) A Form FHA-2800 application.
- b. Any of items (1) through (6) above may be waived by the local office as necessary documentation to be submitted with the Form

FHA-2800 application. Such a waiver is appropriate only in those instances where the office has previously processed an application for 203(n) insured financing involving the same cooperative and determined that the organizational documents were acceptable. See paragraph 1-13 of the Handbook for the detailed procedure of receiving and approving the documents.

- c. Conditional Commitment. - The initial application for appraisal under the Section 203(n) program is submitted on Form FHA-2800.
  - (1) Upon receipt of the Form FHA-2800 application and a review for completeness of the application and exhibits, the receiving clerk will establish a file.
  - (2) Once a case number has been assigned, the Form FHA-2800-2 will be removed by the receiving clerk from the Form FHA

2800 package and returned to the mortgagee to acknowledge acceptance of the application.

- (3) The appraiser will complete the Form FHA-2800 as in all other applications. However, it may be necessary to document the findings and decisions reached by means of a memorandum attached to the FHA 2800 report. When the appraiser completes the report, the appraiser's estimated value of the unit shall be set forth under the heading "Estimated Value of Property" on the Form FHA-2800-5. The monthly expense estimates will be included on the Form FHA-2800-5, block 7, with appropriate handwritten pen changes being made to the titles of the lines or blocks and specific commitment conditions should be checked or filled out, where appropriate, and an addendum sheet attached, when necessary. A copy of the Addendum to the Statement of Appraised Value, Appendix 4, and HUD Fact Sheet 321-F-(5) must accompany the conditional commitment when issued.

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- (4) The mortgagee is responsible for providing the Statement of Appraised Value, as well as the Addendum and the HUD Fact Sheet, to the borrower prior to the Form FHA 2900-1, Mortgagee's and Mortgagor's Application for Mortgagor Approval and Commitment for Insurance under the National Housing Act, being signed by the borrower.
  - (5) A copy of any memorandum used to document the report must be made and accompany Forms FHA 2900-3, Firm Commitment Application, and 2800-4, Conditional Commitment Application, being sent to the Management Information Systems Division after insurance endorsement.
- d. Firm Commitment. - Applications for approval of the mortgagor and issuance of a firm commitment are submitted on Form FHA 2900. The firm commitment is issued on Form FHA 2900-4.
- 1-12. MORTGAGE FORM - No specific mortgage form is required to be used under the program. However, the following

instructions are applicable.

a. The mortgage submitted for insurance must:

- (1) Involve a principal obligation in multiples of \$50.
- (2) Have the payments come due on the first of each month.
- (3) Have an amortization period of either 5, 10, 15, 20, 25, or 30 years by providing for either 60, 120, 180, 240, 300 or 360 monthly payments but not to exceed the remaining term on the project mortgage.
- (4) Provide for payments to principal and interest to begin not later than the first day of the month following 60 days from the date the mortgagee's certificate on the commitment was executed.

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- (1-12) (5) Contain a provision permitting the mortgagor to prepay the mortgage in whole or in part upon any interest payment date after giving to the mortgagee 30 days advance notice in writing of intention to prepay, but shall not provide for the payment of any charge on account of such prepayment.
- (6) Contain mortgage terms that do not exceed those set forth in the firm commitment.
- (7) Be executed by the same person(s) as named in the firm commitment.
- (8) Set forth that if the loan is held by the Federal Housing Commissioner, the mortgagor will pay to HUD a monthly charge (in lieu of the mortgage insurance premium) which shall be in an amount equal to one-twelfth (1/12) of one-half (1/2) per centum of the average outstanding balance due on the mortgage loan without taking into account delinquencies or prepayments.
- (9) Set forth that the aggregate of the amounts required to be paid under the mortgage shall be paid in a single payment each month to be applied by the lender first in payment of HUD's mortgage insurance premium, then to interest payable on the mortgage, then

to the principal on the note, and then to late charges, if any.

- (10) Contain a "Resolution of Inconsistency" which states: "If this mortgage and note be insured under Section 203(n) of the National Housing Act, such Section and Regulations issued thereunder and in effect on the date hereof shall govern the rights, duties and liabilities of the parties hereto, and any provision of this or other instruments executed in connection with this mortgage and note which are inconsistent with said Section of the National Housing Act or Regulations are hereby amended to conform thereto."

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- (1-12) b. The mortgage may provide for:
- (1) A late charge not to exceed four (4) cents for each dollar of each payment more than fifteen (15) days in arrears, to cover the extra expense involved in handling delinquent payments.
  - (2) Equal monthly payments by the mortgagor to the mortgagee which will amortize the fire and other hazard insurance premiums, if any are required by the mortgagee, within a period ending one month prior to the date on which the same becomes delinquent.
  - (3) Authority for the lender to collect from the borrower each month, until the note is paid in full, one-twelfth (1/12) of the annual mortgage insurance premium (MIP) charged by the Department for providing mortgage insurance on the mortgage loan. The mortgagee is responsible for the payment of the MIP. HUD regulations permit the mortgagee to collect the funds necessary for the payment from the mortgagor. Accordingly, if the mortgagee is going to collect the funds from the mortgagor, authority to do so must be included in the mortgage.
  - (4) Contain a provision which states that failure of the mortgagor to pay the mortgagor's share of the common expenses or assessments and charges imposed by the

corporation as provided for in the instruments establishing the cooperative shall constitute a default under the provisions of 203(n) of the Housing Act.

- c. As was previously mentioned, no specific mortgage form is required to be used under the program. Before a mortgage form can be used, however, it must be found acceptable for use under the Section 203(n) program by the local HUD Field Office. In this regard, a mortgagee anticipating funding 203(n) mortgages should have its legal counsel prepare a draft 203(n)

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- (1-12) mortgage form reflecting these instructions, applicable HUD regulations and State and local statutes dealing with cooperatives.
- (1) Thereafter, when the mortgagee submits its initial application for insured financing under Section 203(n), the mortgagee will include a copy of the proposed mortgage form. The covering letter required to transmit the application should be expanded to mention that an initial application is involved and the proposed mortgage form is included with the application package.
- (2) Upon receipt of the application and the proposed mortgage form, the proposed form will be forwarded to the Area Counsel. Instructions contained in paragraph 1-13 relating to the approval of the organizational documents are also applicable to approval of the mortgage form. The sample format letter in Appendix 3 should be adjusted to reflect that a mortgage form is involved instead of the organizational documents. Use of one letter to approve both the organizational documents and the mortgage form is permitted if the local Field Office finds this more convenient.
- (3) In addition to the above, a copy of the letter approving the mortgage form, together with a copy of the mortgage form itself, shall be provided the Assistant General Counsel for Home Mortgage Insurance in Headquarters. This will permit a post-review of the mortgage form and enable Headquarters personnel to be familiar with various State and local requirements as

they relate to cooperatives.

- (4) Since the mortgagee will be closing subsequent loans on the approved mortgage form, Field Office approval of the form, when each application is submitted, is not necessary. However, the mortgagee must submit documentation with each closing submission evidencing HUD's approval, and a requirement of this nature should be included on each

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conditional commitment which is issued under Section 203(n). The requirement should read as follows:

"A copy of the letter issued by the Director of this office approving the format of the security instrument upon which the loan will be closed must be submitted with the submission for insurance endorsement. In addition, the following certification must accompany the copy of the letter. "The provisions contained in the security instrument are identical to those approved by HUD under letter dated \_\_\_\_\_ (copy attached) \_\_\_\_\_ Mortgagee."

- (5) If the proposed mortgage form is not acceptable, the conditional commitment may still be issued but a condition should be placed on the commitment requiring HUD approval of the mortgage form before insurance endorsement will take place.

1-13. ORGANIZATIONAL DOCUMENTS

- a. HUD regulations require that the organizational documents of the cooperative corporation provide for the following:

- (1) Either the Secretary or a mortgagee under a mortgage insured under this section shall be a member of the cooperative corporation for so long as either owns a Corporate Certificate;
- (2) A mortgage insured under this section shall be a first lien upon the property covered by the mortgage;

- (3) The Secretary may exercise the voting rights which are attributable to each Corporate Certificate owned by the Secretary;
- (4) The Secretary may designate an agent as proxy for the purpose of exercising the voting rights of the Secretary which are attributable to the Corporate Certificate or Certificates owned by the Secretary;

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- (1-13) (5) The Secretary may cease making monthly payments attributable to any dwelling unit for which the Secretary owns a Corporate Certificate six months after the Secretary notifies the corporation to sell the Corporate Certificate or upon default by the corporation on the blanket mortgage covering the dwelling unit;
  - (6) The Secretary or a mortgagee shall not be obligated to make payments to the corporation for any amounts unpaid by a mortgagor under a mortgage insured under this section prior to the date the Secretary or the mortgagee becomes the owner of the Corporate Certificate.
- b. Upon receipt in the Field Office of a Form FHA 2800, the organizational documents which accompany the application will be forwarded to the Area Counsel in order that they can be reviewed to determine if they are in accordance with the suggested organizational documents set forth in Reference 2 of the Foreword.
- (1) If they do correspond, a letter of approval signed by the Area Office Manager/Service Office Supervisor indicating their acceptability should accompany the conditional commitment when it is issued (see Appendix 3 for sample format letter).
  - (2) If there are significant differences, copies of the organizational documents must be immediately forwarded to the Office of the Assistant General Counsel for Home Mortgage Insurance with a request for a review and comments.
  - (3) The Field Office will be notified of the documents' acceptability by the Assistant

General Counsel.

- (4) If minor differences are evident, the Area Counsel may discuss such differences informally with the Office of the Assistant General Counsel and render an opinion based upon such a discussion.

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- (5) Processing of the application should continue while the Area Counsel's review is taking place.
- (6) If the documents are unsatisfactory, a conditional commitment should not be issued, and an explanation of the reason(s) they are unsatisfactory should accompany the report on application Form FHA 2026, in order that the mortgagee can notify the cooperative accordingly. Such reasons will be provided by the Area Counsel or in the event the documents were forwarded to the Office of General Counsel for review, that office will notify the field of any reasons of unacceptability.
- (7) Files should be established containing the copies of the organizational documents and letters of approval. For subsequent conditional commitment applications submitted by a mortgagee involving a cooperative whose documents have been approved, the Field Office may waive the requirement that copies of the organizational documents be submitted. If a waiver is granted, the application must be accompanied by a copy of the approval letter and a certification from the cooperative that no changes have been made in the organizational document since issuance of the approval letter. A provision setting forth the waiver is included in the sample format letter in Appendix 3. The certification language is also set forth in the format letter.

1-14. REVIEW FOR INSURANCE ENDORSEMENT - The closing clerk will handle the submission for insurance endorsement as outlined in reference (3) of the Foreword, except that a HUD mortgage form is not required to be used. Any mortgage form which has been approved by the Area Manager or Service Office Supervisor is acceptable. A copy of the letter of approval must

accompany the closing submission together with an executed certification as required in paragraph 1-12c(4). The closing clerk will review the mortgage and note to determine that they are in compliance with the terms of the commitment.