
CHAPTER 2. UNDERWRITING INSTRUCTIONS

- 2-1. COST PROCESSING. Proposed projects submitted under this Section are processed and estimated in accordance with instructions covering Section 203(b) home mortgage cases.
- 2-2. ARCHITECTURAL PROCESSING. The purpose of Rehabilitation and Neighborhood Conservation Housing Insurance is to aid in the elimination of slums and blighted conditions and to prevent the deterioration of residential property through new construction and the rehabilitation of existing dwellings in Urban Renewal Areas, in concentrated code enforcement areas under Section 117 of the Housing Act of 1949, or in such other areas as may be prescribed by the HUD-FHA Regulations.
- a. Processing: Applications submitted under Section 220(d)(3) (A) are processed in accordance with effective instructions for Section 203(b) as modified below.
- b. Standards or Requirements:
- (1) New and Proposed Construction:
- (a) For properties having one or two living units, architectural processing and application of minimum requirements shall be in accordance with outstanding instructions for properties submitted under Section 203(b).
- (b) For properties having three or more living units, the Minimum Property Standards for Multifamily Housing are applicable as stated therein.
- (2) Existing Structures to be Rehabilitated:
- (a) The standards or requirements approved for the area by HUD-FHA provide the minimum acceptable to establishing standards are contained in reference (1) of the Foreword.
- (b) Existing properties which were constructed or rehabilitated pursuant to the Urban Renewal Plan, accepted by HUD-FHA, may need no rehabilitation, but all other existing properties shall involve proposed rehabilitation of the structure.

- (c) Rehabilitation may involve little more than painting and limited refurbishing to be acceptable as meeting the standards and requirements in effect, and would suggest the minimal type of rehabilitation.
 - 1 This will usually occur in an existing property which is sound in plan and construction, conforms to standards and requirements in effect for the area, and which received continued or periodic good maintenance and modernization to minimize obsolescence.
 - 2 Other properties which are deficient in these respects and are obsolete, deteriorated or otherwise blighted and lacking reasonably long economic life will require a greater degree of rehabilitation.
 - 3 For all properties, except those whose exteriors were recently cleaned, painted or otherwise renewed, some exterior cleaning or refinishing should be required which will contribute to the general appearance of the neighborhood.

2-3. VALUATION PROCESSING INSTRUCTIONS.

- a. Appraisal activities consist of both pre-application services and processing services. Advisory services are furnished to the Local Planning Authority and upon request, and preferably as early in the initiation of the program as possible.
 - (1) The field office may be requested by the redevelopment agency of the city to collaborate in the site inspection of the proposed area if Section 220 mortgage insurance is contemplated.
 - (2) In some instances, the field office will be expected to make appropriate recommendations to the assured that (1) the limits of the proposed area are properly defined to permit necessary assumption of mortgage risk under Section 220, and (2) any necessary conditions to the eligibility of the location are established. These will then be embodied in a single statement of all conditions to the local public agency prior to approval of the urban renewal area.

-
- (2-3) b. Preliminary Analysis. HUD-FHA analysis during the development of an urban renewal plan should cover; (1) suitability of proposed urban renewal areas, (2) economic desirability or proposed treatment (e.g., rehabilitated vs. clearance), (3) adequacy of proposed neighborhood replanning, (4) adequacy of public improvements, facilities, and services for the project, (5) probability of adequate private investment in new construction and rehabilitation, (6) marketability of the final accommodations and acceptability for mortgage insurance.
- c. The Workable Program. The Workable Program, submitted by the governing body of the locality and approved by the Secretary, is the comprehensive program for the entire community and is the basis for specific urban renewal or neighborhood plans. All members of the Valuation staff assigned to work in the Urban Renewal Area must be fully aware of the provisions of the approved Workable Program.
- d. The Urban Renewal Plan. The second step is the development of the specific Urban Renewal Plan(s). This plan will be developed by the local governing body and will precisely delineate a specific portion of the programmed rehabilitation or renewal area. It will also outline in detail the neighborhood alterations and improvements proposed by the governing body of the locality.
- (1) It is anticipated that the delineated area will be either:
- (a) Large enough to constitute a neighborhood in itself, or
 - (b) Contiguous with a neighborhood eligible for insurance under Section 203(b) or 207, or
 - (c) So situated that the delineated area will reflect the beneficial influence of proximity to an abutting major commercial district; public lands, parks, or civic centers; or a freeway or boulevard. The delineated area must not be subject to the adverse effect of neighborhood substandard areas.
- (2) The plan will state precisely the commitments which the community will make for the improvement of the neighborhood. The items to which the locality is committed for completion will generally include:
-

- (2-3)
- (a) Protection Against Inharmonious Land Uses. Zoning ordinances, building codes and protective covenants should be such as to provide protection against inharmonious or improper uses and to insure continuing residential utility of cleared, rehabilitated or renewal areas. Such existing uses as are non-conforming to the planned area and are seriously detrimental to residential use will be abandoned or suitably restricted or isolated. Buildings condemned, or otherwise found unsuitable for rehabilitation or renewal, will be razed. The development of areas thus vacated, or other vacant areas, will be properly planned.
 - (b) Physical and Social Attractiveness. This quality is closely related to and affected by the degree of protection against inharmonious land uses, and to the commitments in the plan regarding the removal or mitigation of special hazards and nuisances. Acceptable street and neighborhood design and landscaping of public areas are favorable factors. All conditions affecting the health and safety of the occupants and their pleasure and pride in residing in the neighborhood should be considered, and improved, to the maximum extent feasible.
 - (c) Adequacy of Civic, Social and Commercial Centers. Public school facilities should be adequate and suitable as to convenience of location, capacity, and the physical structures to be used. Neighborhood stores and neighborhood or central shopping centers should be available and conveniently situated, or their construction should be assured. Designation of new sites for commercial development may be desirable. Assurance should be had that recreation facilities, playgrounds, theaters, etc., will be available, preferably both indoor and outdoor. These may include facilities in conjunction with public schools. Churches may not be included in the officially committed list of neighborhood improvements; however, they should be available.

- (2-3)
- (d) Adequacy of Transportation. Necessary transportation facilities sufficient for the replanned area should be assured. These will include facilities for mass transportation, integrated with highway and pedestrian access.
 - (e) Sufficiency of Utilities and Services. The streets and other off-site utilities and services in the area should be redesigned, as necessary, to assure adequate arterial traffic routes, parking facilities, and the necessary utilities and services.
 - (f) Level of Taxes and Special Assessments. Assessed values must be in proper and realistic relationship to existing and prospective residential market values. The pyramiding of assessed values by adding to an existing exorbitant base an increase to cover rehabilitation costs, repairs, etc., may result in an assessment in excess of that pertaining to other residential areas. Assessed values of land cleared for reuse must bear a proper relationship to the economic value of such land.
- e. Underwriting Reports, FHA Forms 2800-3 and 2017A. Reference (2) of the Foreword where required, will be completed in accordance with outstanding instructions, with the following exceptions: The analysis of location is accomplished in the customary manner always assuming the completion of those betterments and improvements to which the local governing body is committed. In this way, the subject location can be readily compared with competitive locations. The application of the analysis resembles that used in subdivision analysis in that the adequacy and acceptability of the various features are made on the basis of existing suitable facilities and amenities, plus those facilities assured of completion by the community.
- f. Proposed Construction Cases. Since mortgage amounts on proposed construction cases are based upon the HUD-FHA Estimate of Replacement Cost, it will be unnecessary to develop estimates of market price of the property or capitalized income. All items on FHA Form 2800-3 will be completed except Box 35 "Capitalized Income." Box 36 "Market Price" and Box 34 "Comparables." In Box 6 "Value of Property" should be marked through and "Replacement Cost" entered on the first line. Closing costs are added, as in all cases, to reach the Total.

-
- (2-3) (1) Section 226 of the National Housing Act requires that the purchaser of a property to be covered by mortgage insurance by HUD-FHA receive a statement of "appraised value" prior to purchase of the property.
- (2) However, in proposed construction cases under Section 220, a statement setting forth the Assistant Secretary-FHA Commissioner's estimate of "Replacement Cost" instead of "Value" is issued to the purchasers of one and two family residences. Therefore, in such cases, it will not be necessary to establish an estimate of value.
- g. Market Price of Site. Estimated Market Price of Equivalent Site will be made in accordance with outstanding instructions with the following exceptions: Comparisons and resulting market price estimates are made on the basis of the most profitable, or highest and best likely use of the site permitted under the neighborhood Urban Renewal Plan and revised zoning ordinances. Where sites are located in designated urban renewal or redevelopment areas and are cleared, (or will be cleared) with the aid of Federal subsidies and the cleared sites are sold by the municipalities, the "Estimated Market Price of an Equivalent Site" in each case shall not exceed the purchase price of the land as set forth in the land purchase contract.
- (1) The comparative analysis, including any related studies conducted by the application of land residual capitalization will require assumption that the commitments of the locality as to improvements, public facilities, schools, etc., will be fulfilled.
- (2) Existing comparable sites used as the basis for these estimates will properly include sites outside the area covered by the renewal plan which are similar (but not necessarily identical) and which have similar actual or potential utility. Thus a proposed site within the area will be assumed to have the benefit of all commitments made by the community in the renewal plan.
- (3) The site will be compared with sites outside the area, which have similar facilities, services, and amenities, and which may be put to similar uses.

- (2-3) (4) The site will also have the benefits that accrue from such commitments made with respect to other Urban Renewal Plans within the competitive housing market area.
- (5) In using sites within Urban Renewal areas as a basis for comparison, adjustments may be necessary to reflect the effect of the commitments on the community, especially in applying data pertaining to transactions prior to the advent of publicizing of the Urban Renewal plan.
- h. Existing Construction Cases. In the case of existing construction, the amount of the mortgage will be based upon the sum of the estimated cost of repair or rehabilitation and the Estimate of Value of the Property before repair or rehabilitation. Valuation concepts utilized in estimating the value of existing properties before improvements or rehabilitation are outlined in subsequent paragraphs.
- (1) An applicant for a loan to purchase an existing home is not eligible for insurance under Section 220(d)(3)(A) unless some repair or rehabilitation of the property is involved in the transaction.
- (2) This requirement is met even though repairs or rehabilitation may have occurred prior to the mortgagee submitting an application for insurance, provided such improvements were completed in accordance with, and subsequent to, the date of the Secretary's approval of an Urban Renewal Plan.
- i. General Valuation Concepts. Valuation processing under Section 220 differs basically from Section 203 in that Valuation analysis must give full consideration not only to existing influences but to specific changes for improvements and alteration of the neighborhoods to which the governing body of the locality is committed. It is common appraisal practice to give effect to the probability of such changes taking place and to analyze the effect in terms of value. While it is realized that there may be some lapse of time between the planning stage and completion of commitments made under the plan, the valuator is to assume completion in accordance with the commitments made by the community and thus is not required to base his conclusions upon conjecture.

-
- (2-3) (1) There will be other unusual problems for consideration.

In any area of blight, slum clearance, rehabilitation or conservation, the potential demand for dwelling units in the newly constructed neighborhood must be studied. The Workable Program will have included an inventory of housing resources and surveys of housing needs. These reports, supplemented, if necessary, by market studies made by the appraiser or by the Housing Market Analyst, should be used in estimating the demand, sale and rental potential of specific properties.

- (2) The analysis of potential demand will consider that which may be derived within the delineated area together with that from other, possibly competitive, neighborhoods. Values for sale and for rental of the dwelling units in the reconstructed area must bear a proper relationship to the financial abilities and demonstrated preferences of the prospective consumers. These consumers may be present residents in the neighborhood, residents from other neighborhoods who are expected to desire to own or rent units here, or a combination of both.
- (3) The extent, probable time required to accomplish, and the effect of citizen participation in the city-wide program and more specifically in the fulfillment of the Urban Renewal Plan, will be important in the valuation process. As with evaluating any trend, both present accomplishments and future probabilities must be taken into account, and their effects translated into value.
- (4) A summation of the general valuation concepts discussed herein can be made in the following manner:
 - (a) Appraisals will assume the completion of the specific neighborhood improvements to which the locality is committed in the approved urban renewal or redevelopment plan. This includes not only the improvements to be paid for by local public agencies, such as streets, utilities, parks, schools, land clearance, etc., but also the improvements to privately-owned real estate which will have to be made as a result of the enforcement of local codes.

-
- (2-3)
 - (b) Appraisals will assume the completion of those improvements to which the locality is committed in other urban renewal or redevelopment areas and will consider the influence which such improvements exert

on the subject area.

- (c) Appraisals will assume the completion of those provisions of the Workable Program which the local governing body has agreed to make effective concurrently with the subject urban renewal or redevelopment plan. Examples of these additional provisions would be general improvement programs for utilities and streets, etc.
 - (d) Appraisals will assume the completion of the above commitments when evaluating appraisal factors such as rental rates, occupancy ratios, economic life, and capitalization rates. All appraisal estimates will be made on a comparison basis with similar properties in neighborhood which will be competitive with the subject property and area after the urban renewal or redevelopment plan is completed.
- j. Comparative Data. The use of market prices for equivalent and nearly equivalent properties in the neighborhood must be judicious. Adjustments will be necessary in initial cases to weigh the results of the comparison in the light of the assured neighborhood renewal in prospect. As the renewal plan progresses, comparative data should also reflect the beneficial influences and finally be usable without adjustment for this factor. Comparisons should not be confined to the delineated area. More accurate estimates of value may result from comparison with residential property in other neighborhoods, which will be competitive when the improvements committed in the Urban Renewal Plan have been completed.
- (1) Comparable property need not be identical but should compete for the same general segment of the market.
 - (2) Thus, facilities and amenities offered in competitive areas, similar to those to be made available in the delineated area, will provide excellent bases for estimating prices and value.

-
- (2-3) k. Value by Capitalization Before Improvement and Rehabilitation. Rental estimates, rent multipliers, and capitalization rates should reflect the effects of the Urban Renewal Plan in the designated area. Income streams, operating and maintenance expenses, vacancy and collection losses, and taxes must be estimated with due recognition to the Urban Renewal Plan and

its effect upon each factor which enters into the appraisal process.

1. Preparation of Underwriting Reports. The mortgage amount in existing construction cases will be based on the sum of (a) the Estimated Cost of Repair, Rehabilitation and/or Improvement, plus (b) the Value of the Property Before Repair, Rehabilitation or Improvement. This will necessitate preparation of two Underwriting Reports, FHA Form 2800-3 (or 2800-3 supplemented by 2017A on rental income cases) on each case. These forms will be identified with bold lettering as "Before Rehab (Preliminary Report)" and "After Rehab (Final Report)." Each will be prepared as follows and after completion of processing stapled together:

- (1) Before Rehab (Preliminary Report). This form will show the value of the property "as is" before any repairs, rehabilitation or improvement. The estimate will be developed in the usual manner for Section 203(b) Amenity-Income or Rental-Income cases, except closing costs at this stage of processing will be omitted. The Underwriting Report will be entirely completed utilizing the Cost, Market Data, and Capitalization approaches to value, as they are applicable. The total for mortgage insurance purposes shall be amended to indicate "Value of Property Before Repair or Rehabilitation." The "as is" value of the property will be estimated assuming the subject property will be brought into compliance with local building codes and zoning. Uses, design, or the lack or insufficiency of equipment, which are in violation of codes, often result in market prices above the levels warranted if local codes were enforced. The "as is" value will reflect only the benefits which arise from legal use of the property in compliance with codes and zoning in the locality. No closing costs will be added and the Total (as is) will be entered on the bottom line of Box 36 in the same amount as the "Value (Excl. Cl. Costs)."

12/72

Page 2-10

HUD-Wash., D. C.

4245.1 CHG

-
- (2-3) (2) After Rehab (Final Report). On this form the final estimate upon which the mortgage is based will be entered as the sum of "as is" value plus cost of rehabilitation. The cost estimate of proposed and required improvements or alterations will be prepared in Box 32 in which the heading "Replacement Cost" is amended to read, "Cost of Rehab."

(a) The total cost of "Rehab" from the bottom line of Box 32 will be entered in Box 36. In Box 38 the Valuator will list:

- 1 Estimated Cost of Repairs and/or improvements from Box 32 \$
- 2 Value Before Rehab. from Box 36 of "Before Rehab (Prelim. Report)" \$
- 3 Closing Costs \$
- 4 Cost of Repair or Rehab. plus Value before Rehab. plus closing costs (Total 1 + 2 + 3) \$

(b) Monthly rental value, operating expenses, net income estimates, estimated remaining economic life, and the monthly estimate in Box 7, will be completed (for use of the Mortgage Credit staff) reflecting conditions that will exist after the proposed work is completed.

(c) No other entries or estimates are required on the "Final" Underwriting Report by the Valuator. No entries are made in Box 6 except a notation, "Not Applicable." Boxes 8 through 10 are completed by the Authorized Agent using the valuation estimates in Box 36 to determine the commitment amount. Before issuance of the conditional commitment, the valuation estimates on the "Final" Underwriting Report are typed on Form FHA-2800-5 (both copies) in the space at the bottom of the page below any Specific Commitment Conditions that may be entered, as follows:

HUD-FHA Estimates

Cost of Repairs and/or Improvements. \$
Value before Rehabilitation. \$
Closing Costs \$ _____

Cost of Repair or Rehab, plus Value
of Property before Rehabilitation. . . . \$

- m. Leaseholds. In leasehold cases the value of the property before repair or rehabilitation will be found in fee simple and the ground rent and the value of the leased fee will be recorded under "Remarks" in Box 38 as in other cases.

2-4. MORTGAGE CREDIT PROCESSING.

a. Maximum Insurable Mortgage.

(1) Occupant Mortgagors.

- (a) \$60,000 on a one-family dwelling; or
\$65,000 on a two-family dwelling; or
\$65,000 on a three-family dwelling; or
\$75,000 on a four-family dwelling; or
\$82,700 on a five-family dwelling; or
\$90,400 on a six-family dwelling; or
\$98,100 on a seven-family dwelling; or
\$105,800 on an eight-family dwelling; or
\$113,500 on a nine-family dwelling; or
\$121,200 on a ten-family dwelling; or
\$128,900 on an eleven-family dwelling; and
- (b) If the application involves the proposed construction of a new single family dwelling and is approved for mortgage insurance prior to the beginning of construction:

-
- (2-4)
 - 1 97% of the first \$25,000 of the estimated replacement cost of the property, plus 95% of such replacement cost in excess of \$25,000.
 - 2 If the application involves a single-family dwelling and is accompanied by a certificate issued by the Veterans Administration or the Secretary of Defense:

100% of the first \$25,000 of the HUD-FHA replacement cost of the property, as of the date the mortgage is accepted for insurance, or the sum of the HUD-FHA replacement cost if not in excess of \$25,000 and the items of prepaid expense less \$200, whichever is the lesser, and 95% of the HUD-FHA replacement cost in excess of \$25,000.

- (c) If the application involves a new dwelling under construction and is approved for mortgage insurance after the beginning of construction and prior to the completion of construction:

90% of the first \$25,000 of the estimate replacement cost of the property, and 95% in excess of \$25,000.

- (d) If the application involves an existing dwelling which was approved for mortgage insurance prior to the beginning of construction or has been completed more than one year:

97% of the first \$25,000 of the sum of (i) the HUD-FHA estimate of the value of the property before repairs or rehabilitation (if any, proposed or required) and (ii) the estimated cost of the repairs or rehabilitation, if any, (100% of the first \$25,000 of the sum of (i) and (ii)), or the sum of (i) and (ii) not in excess of \$25,000 and

2/78

Page 2-13

HUD-Wash., D. C.

4245.1 CHG

(2-4) prepaid expense, less \$200; whichever is the lesser, (if the applicant is an eligible veteran), plus 95% of such sum in excess of \$25,000.

- (e) If the application involves an existing dwelling which was not approved for mortgage insurance prior to beginning of construction and the construction has been completed less than one year:

90% of the first \$25,000 of the sum of the HUD-FRA estimate of value of the property before repairs or rehabilitation (if any proposed or required) and the estimated cost of repairs and rehabilitation, if any, plus 95% in excess of \$25,000.

- (f) When the application involves the refinancing of existing indebtedness, the sum of the estimated cost of repairs and rehabilitation, and the amount required (including items of prepaid expense) to refinance the existing indebtedness secured by the property plus any existing indebtedness incurred in connection with improving, repairing, or rehabilitating the property.

NOTE: Based on legal opinion, properties which are being purchased under long term contracts providing for installment payments over a period of years can properly be refinanced under this Section. The amount of the outstanding obligation under such a contract may be considered as an "existing indebtedness secured by the property." However, a contract in existence for less than approximately six months may be considered as interim financing and the application processed as a "purchase transaction."

- (2) Properties Held for Rental. Where the mortgagor is not the occupant of the property, or a unit thereof, and certifies to the Assistant Secretary for Housing-Federal Housing Commissioner that he intends to hold the property for rental purposes, the principal amount of mortgage shall not exceed:

2/78

Page 2-14

HUD-Wash., D. C.

4245.1 CHG

-
- (2-4) (a) 93% of the amount available to an owner-occupant mortgagor computed under the provisions of Paragraph 2-4a(1)(a) thru (e);
- (b) The amount available to an owner-occupant mortgagor computed under the provisions of Paragraph 2-4a(1)(f).
- (3) Properties Held for Sale. In case of a one- or two-family dwelling to be constructed, repaired, or rehabilitated, where the applicant is not the occupant of the property, or a unit thereof, and certifies to the Assistant Secretary for Housing-Federal Housing Commissioner that he intends to hold the property for sale, the principal amount of the mortgage shall not exceed:

- (a) 85% of the amount available to an occupant mortgagor, other than veteran, computed under the provisions of Paragraph 2-4a(1)(a) thru (e), or
- (b) The amount available to an owner-occupant mortgagor computed under the provisions of Paragraph 2-4a(1)(f), or
- (c) The amount computed under the provisions of Paragraph 2-4a(1)(a) thru (e), to other than a veteran, provided the transaction is eligible under the escrow commitment procedure, and at least 15% of the original principal amount of the mortgage, or such higher amount as may be required to meet the limitations under (3) (b) above and the minimum cash investment requirements, is deposited in escrow, trust or special account for credit on the mortgage in the event the property is not sold to an acceptable owner-occupant mortgagor within 18 months.

b. Cash Investment. In any case the mortgagor's cash investment must equal the difference between the total cost of acquisition and the amount of mortgage to be insured, but in no event less than amounts indicated below:

- (1) If the dwelling is approved for mortgage insurance prior to the beginning of construction, or the construction of the dwelling has been completed more than one year prior to the application for mortgage insurance:

2/78

Page 2-15

HUD-Wash., D. C.

4245.1 CHG

-
- (2-4) 3% of the first \$25,000 of the cost of acquisition, plus 5% of such acquisition cost in excess of \$25,000 or in case of a veteran:

\$200 of the sum of (1) the total cost of acquisition not in excess of \$25,000 and (2) the items of prepaid expense; and 5% of the total cost of acquisition (exclusive of the items of prepaid expense) in excess of \$25,000.
 - (2) If the dwelling was not approved for mortgage insurance prior to the beginning of construction and the construction of the dwelling has been completed less than one year prior to the date of the application for mortgage

insurance:

10% of the first \$25,000 of the cost of acquisition,
and 5% in excess of \$25,000.

- c. The Term of Mortgage shall not exceed three-quarters of the remaining economic life of the building improvements, and 20 years with respect to firm commitments involving one- and two-family dwellings to be constructed, repaired or rehabilitated and held for sale, except under the Escrow Commitment procedure the term may be 30 years.