

CHAPTER 2. UNDERWRITING INSTRUCTIONS

- 2-1. COST PROCESSING. Projects submitted under this Section shall be processed and estimated in accordance with the Section of the Act under which they are submitted pursuant to Section 223.
- a. When requested by the ADTS, MFC or ADSF/CU, the Cost Analyst shall prepare estimates for repairs, minor rehabilitation and/or for work that is to be escrowed.
- 2-2. ARCHITECTURAL PROCESSING - GENERAL. To assist governmental agencies in the sale of existing properties, HUD-FHA may insure mortgages under any Section or Title of the Housing Act pursuant to Section 233. In this connection HUD-FHA provides an expression of eligibility of such properties for mortgage insurance that may be used by the governmental agency in disposing of them, and to subsequently insure mortgages on the properties. Eligibility and acceptability may be predicated upon requirements for necessary repairs and improvements.
- a. To be eligible the property shall:
- (1) Comply with the eligibility criteria set forth in Section 203.43 of HUD-FHA Regulations.
 - (2) Contain not more than eight living units.
(Properties having five or more living units may also be submitted as project mortgages pursuant to Section 233.) Under Section 222 pursuant to Section 223, properties may have not more than one living unit.
 - (3) Comply with the General Acceptability Criteria and the applicable objectives of the Minimum Property Standards.
 - (4) Have accommodations, appeal and cost of maintenance and operation comparable with competitive properties.
 - (5) Be suitable for type of use, ownership, occupancy and management proposed.
 - (6) Have complete utility services without dependence on other properties, except for such joint utilities as are protected by acceptable easements. As in all properties accepted by insurance, easements must be minimized and careful note must be made of any that are likely to present adverse effects.

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- b. Eligibility is ascertained by examination of the premises and any exhibits provided. Where any deficiency exists and correction is feasible appropriate requirements are made as conditions of acceptance.

- c. Working drawings and specifications composed primarily of the original contract drawings will be provided by the governmental agency for processing purposes but will not be retained permanently by HUD-FHA. Supplementary drawings and specifications, in duplicate, shall be required when necessary to show any modifications and improvements. A general site or plot plan is required in duplicate and must show the boundaries of the utilities thereto, when a subdivision of the original project is proposed. These are retained by HUD-FHA together with supplementary drawings in the master binder and reference is made thereto in other binders for each case.

2-3. SINGLE FAMILY PROCESSING. Architectural processing will conform to the procedures for Section 203(b), existing construction, except that the processing will be performed in the following four stages when the sale of groups of properties requiring repairs and rehabilitation is involved. These stages are: Preliminary, Appraisal and Eligibility, Precommitment and Compliance.

a. Preliminary Stages.

- (1) The objective of this stage is to determine, with a reasonable degree of certainty, the suitability and eligibility of the property for mortgage insurance and to establish the essential repairs and improvements as well as to recommend others which are beneficial and feasible. It is also necessary to approximate replacement cost in new condition as well as the cost of repairs, alterations and improvements, including the costs of recommended items.
 - (a) FHA Form 2800-3 will be used for this purpose.
 - (b) However, a commitment (FHA Form 2800-5) is not issued at this stage, since a formal application for mortgage insurance has not been submitted.
- (2) Examination and use of forms as described will be necessary but not with the degree of thorough study anticipated in the later stage of processing. The exercise of judgment and perception should result in a conclusion wherein all major requirements essential for eligibility

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- (2-3) will be established and costs approximated on a realistic basis, so as to avoid the need for a major change of conclusion in subsequent processing stages.
 - (3) Architectural examination of the property is primarily to observe its physical characteristics and to ascertain features which may preclude acceptance, or

which will require excessive expenditures by the owner for maintenance, repair or operation.

- (a) For example, materials which are not durable, or appropriate, or properly assembled; inefficient heating systems or those requiring frequent repair, adjustment or replacement; or structures which are poorly insulated could all involve excessive expense in management which should be recognized even if not evident to a degree justifying immediate correction for eligibility.
 - (b) Other factors such as unsatisfactory method of refuse collection and disposal, water supply and sewage disposal, and deteriorated bathroom floors or walls may be sources of excessive expense in operation.
- (4) In order to provide an orderly record of the physical condition of the property and to facilitate its examination, HUD-FHA Form 2450-R, Report of Architectural Inspection, will be prepared. Circumstances will govern the decision as to whether a single FHA Form 2450-R will suffice, or whether it would be more desirable to use a separate form for each building. Also, during this examination a Description of Materials, FHA Form 2005, is prepared for each basic structure. This will provide a record of the existing construction and will also show, by means of amendments made in red pencil by the processor any new work or changes to be made.
- (5) Requirements must be made for repairs and for replacements which are not needed and which are indispensable to make the buildings sound and safe with respect to sanitary and structural conditions, and to provide appropriate resistance to the elements.

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- (a) If prudent management would indicate that the replacement of an item could be deferred a year or more by repairs, then repairs rather than immediate replacement are to be required.
 - (b) However, in no instance may the correction of a deficiency be deferred if it is in any way of major importance and likely to have an adverse effect on the purchaser's financial ability to continue ownership.
- (6) Requirements to restore to the original state, or to an improved condition of freshness, must be limited to those which are absolutely indispensable to provide living accommodations and appearances necessary to

keep the present tenants or to attract tenants or prospective purchasers of the type anticipated in the market.

- (a) It seldom, if ever, will be necessary to require that the dwelling structure or living unit be put in "equal-to-new" condition.
 - (b) The painting of a building to improve its appearance will not be required when paint is not needed to prevent deterioration.
 - (c) Replacement of wooden steps with concrete steps will not be required if the need for the immediate replacement is not apparent.
 - (d) Decorating will not be required unless necessary to hold the present occupant or to attract a new one.
- (7) Improvements or repairs may appear desirable even though not essential for eligibility. These may increase livability and appeal, or reduce maintenance or operating expenses, all of which would serve to make ownership of the properties more attractive. Any such items should be included as "Recommendations."

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- (2-3) (8) In some instances, it may be found that the condition of the property is such that the expenditures required to make it eligible for mortgage insurance would not be warranted, since the monies so expended would not increase the value of the property sufficiently to make the expenditures feasible. Close collaboration with the other Underwriting Division Sections and the (ADSF/CU) will be required in those instances where this problem is encountered, and early discussion with the governmental agency representatives will be in order.
 - (9) A careful review of FHA Form 2450-R shall be made by the Chief Architect to eliminate from the requirements to be imposed all nonessential items, as well as to satisfy himself that all essential requirements will be made, and if possible that these will be those determined upon during preliminary discussions. He will also review the 2450-R from the point of view of determining the effect of the requirements on the cost of operation and maintenance of the property.
 - (10) At the conclusion of the Preliminary Stage the Chief Architect prepares a memorandum to the ADSF/CU which is routed through the Valuation Section setting forth for each property:

- (a) An opinion as to suitability and eligibility under the Section of the Act that applications are most likely to be submitted. This opinion will include:
- 1 Requirements for correction of deficiencies, if any, essential for eligibility.
 - 2 The approximate replacement cost in new condition together with separate costs of the necessary repairs, replacements or improvements.
 - 3 Recommendations, if any, for repairs, replacements or improvements (not essential but desirable) with the approximate cost of each and reason for recommendations.
 - 4 General comments including any with respect to excessive operating costs.

(2-3) (b) An opinion of ineligibility and reasons.

- (11) If at any stage of processing further modification, changes or repairs appear essential, they must be necessitated on the basis of the acceptability criteria set forth above. While it is desirable that all such matters be disclosed in the preliminary review, they must not be ignored if revealed in subsequent processing stages.

b. Appraisal Eligibility Stage.

- (1) Processing in this stage is similar to the processing of an application to commitment. Each property in a development must receive individual consideration, but use shall be made of repeat case procedures to the extent feasible. Further review of data and conclusions of the Preliminary Stage is required. Also a recheck and additional information may be warranted on FHA Forms 2450-R and 2005, and with respect to other data and conclusions.
- (2) A requirement shall be included in the HUD-FHA report prepared for the governmental agency requesting the appraisal that evidence satisfactory to the Assistant Secretary-FHA Commissioner, shall be submitted prior to the issuance of a commitment to show that the buildings and improvements, existing as well as new, will be acceptable to the agency having jurisdiction and that certification as may be required with respect to occupancy will be granted to the mortgagor.

(3) Recommendations made in the Preliminary Stage are set forth in a memorandum attached to the Underwriting Report. It shall contain the estimated cost of each item and the anticipated benefit and effect of each.

c. Pre-Commitment Stage. Architectural processing in this stage is required only if the application requests mortgage insurance on some other basis than the report transmitted to the governmental agency requesting the appraisal.

(1) If a variation is proposed, a revised Underwriting Report is prepared reflecting the acceptable differences. The exhibits and specific conditions are reviewed for adequacy.

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(2) During this stage an effort is made to see that the applicant is informed of the benefits to be derived from all items previously recommended but not adopted by the mortgagor in the application.

(3) All effective requirements pertaining to the property under consideration are stated and included in the related commitment.

d. Compliance Stage. Compliance inspections conform to effective Section 203 instructions for existing construction with proposed or required alterations, additions or repairs.

2-4. ARCHITECTURAL PROCESSING. Project Mortgages (Reserved).

2-5. VALUATION PROCESSING. Section 203 pursuant to Section 233 involves proposed sales of existing government-owned housing or the first resale thereof within two years after its acquisition from the government. Cases involving properties of not more than four living units shall be, and properties having five or more but not more than eleven living units may be processed under these instructions.

a. Valuation procedures relative to Section 233 vary in some respects from regular Section 203 processing. Processing of Section 233 projects will generally follow this sequence, with variations as necessary to conform to any special statute pertaining to a particular disposal program:

(1) Preliminary Stage

(a) Property Examination

(b) Delineation of Properties

- (c) Tentative Value Estimates
 - (2) Appraisal and Eligibility Stage
 - (3) Pre-Commitment Stage
 - (4) Compliance Stage
- b. The Valuation Section will participate in conference and work closely with the DO/CU, and the Land Planning, Architectural and Mortgage Credit Sections during all stages.

2-6. STAGES OF PROCESSING.

- a. Preliminary Analysis Stage. The Valuation Section will assemble the following appraisal data in addition to other necessary data relative to the subject proposal:
- (1) Outline of the public agency's proposed sales plan.
 - (2) Data relative to maintenance and operation of public rights-of-way and utilities.
 - (3) Tax and hazard insurance data.
 - (4) Current rent schedules.
 - (5) Current operating statements.
 - (6) Waivers of local authority covering any code or zoning violations or, in the absence of formal waivers, some reliable evidence of early availability of such waivers.
 - (7) Proposed protective covenants which are enforceable against the property.
 - (8) A reasonably accurate map delineating the boundaries of the entire property and indicating its net area. Where subdivision of the project is proposed, the property survey is to show the boundaries of the parcels, the location of existing structures, street rights-of-ways, and utility easements, if any.
 - (9) Drawings of the project including site and utility plans, noted to disclose known deviations in the actual construction, or as-built drawings if they are available.
 - (a) Property Examination: Valuation and Architectural Section representatives will

jointly consider the physical condition of the property and the necessity, scope, and approximate cost of any proposed or required repairs, alterations or replacements necessary to put the security in sound and acceptable condition. The Valuation Section will study the neighborhood and assembled data and provide comments and conclusions in determining the general price and rent level. The current and future marketability, and the economic life of the structures will likewise be studied.

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- (b) Delineation of Properties: The Valuation Section will offer advice in establishing the acceptability of properties which require delineation prior to appraisal and sale as separate real estate entities. Existing or proposed easements for service lines or access will be studied to determine their effect on the utility and marketability of the property. Proposed dedication of streets, walks, and other public areas or easements, the assumption by a public body of responsibility for maintenance of such dedicated areas, and the acceptability of the proposed disposition of utility systems shall be considered carefully.
 - (c) Tentative Estimates of Value: The Valuation Section will prepare tentative estimates of value for use in final pre-application conferences. Sample appraisals on carefully selected typical sales units will be made.
- b. Appraisal and Eligibility Stage. FHA Forms 2800-3 and 2017A will be used in processing as per current instructions for Section 203 processing. Since these properties may be in different sales price and rental range from that ordinarily considered in HUD-FHA analyses, data available in office files on competitive properties may be limited. Therefore the collection of applicable and relevant market data in the price range under consideration will be of prime importance. Likewise, the analysis of such comparative data should take into consideration the fact that properties in these price and rental categories may be appropriately equipped on a level less exacting than would normally be required in new Section 203 construction.
 - c. Pre-Commitment and Compliance Stage. Section 203 processing instructions will be followed.
 - d. Valuation Processing of Multifamily Projects Under

Sections 207, 213, 221, 231, 232, and 233 Pursuant to Section 233.

- (1) To provide additional instructions for Valuation processing of applications involving the proposed value of existing government-owned housing or the first resale thereof within two years after its acquisition from the government. In addition instructions are provided for processing multifamily applications for properties located in older declining areas which though otherwise would not be acceptable due to location.

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- (2-6) (2) Valuation procedures relative to these cases differ in some respects from the procedures and concepts applicable to other current HUD-FHA operations. These differences from basic instructions for valuation procedures are described below.
 - (3) Cases involving properties of five or more living units, shall be processed in accordance with the basic Section 207 instructions except as described below.
 - (4) Capitalization Approach. In the valuation of these existing rental income properties, the estimate of replacement cost may be of little worth. The proper approach will be that of capitalization of net income, supported in all instances by market comparisons. Should no recent transactions in similar properties be discovered, comparison shall be made with the properties most closely competitive.
 - (5) Estimate of Income. HUD-FHA will be supplied with a schedule of rents now in effect. Such rentals may or may not be the maximum available in the current market. Therefore, they should be carefully compared with rental data in the data bank.
 - (a) If existing rentals are below the fair market by reason of rent controls or otherwise, consideration must be given the time required for, and the possible tenant turnover occasioned by, a program of adjusting rents upward which would probably be instituted by a purchaser.
 - (b) In those instances where rents are still controlled, an estimate must be made of the probable time during which such controls

will remain in effect and the future income stream calculated accordingly.

- (6) Limitation Upon Net Income. Maximum rent limitations are not imposed by the Assistant Secretary-FHA Commissioner in cases involving disposition of projects by public agencies that are eligible for processing pursuant to Section 223.

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- (2-6) (7) Vacancy and Collection Loss Estimates. Because of the strong demand for housing in some areas, many of the properties may be fully occupied at the time of appraisal. Evidence of continued strong demand may justify a prediction that there will be relatively small vacancy and collection losses for a definite period in the immediate future. However, it will be necessary to adjust this estimate to reflect typical conditions over a long period of time.
- (8) Operating Expense Estimates. The statement of operating expense to be furnished by the public agency will not be entirely applicable to the expense of operation under private ownership only as a guide and should adjust his estimates to agree with the data in the data bank.
- (9) Estimate of Taxes. While in general, the real estate holdings of the government are not taxable, the properties held by the Public Housing Agency are subject to payment in lieu of taxes. The amounts were accepted by agreement between the local agency and the taxing agencies. They were calculated on the basis of the assessment methods, assessed values and tax rates prevailing in the community, except that in some cases it will be found that some services usually supplied by the taxing jurisdictions were omitted and the rates were adjusted accordingly. The assessed value and the resulting obligation are not carried on the tax rolls of the taxing agencies.
- (a) The Valuator must make necessary investigations to determine whether the assessed values and the resultant payments in lieu of taxes under public ownership would represent a fair market estimate of taxes if the property were sold to a private owner. The figure thus determined will be used by the Valuator in processing.

- (b) In the case of state, municipal, or other ownership, the Valuator may or may not have a parallel situation. In any event, he must estimate the probable annual taxes based on private ownership.

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- (2-6) (10) Hazard Insurance. The public agency may carry its own hazard insurance risk. Thus, factual information concerning insurable amounts and rates may not be available from insurance experience with regard to the properties. The types and amounts of hazard insurance and the terms of the policies are to be those typically used in the area by owners of properties of the kinds under appraisal.
 - (11) Estimate of Economic Life. In estimating economic life, consideration will be given the physical condition of structures, together with all other factors bearing upon their continued acceptance in the sales or rental market in the competitive price bracket in which they fall.
 - (a) It must be borne in mind that the type of construction typically found in these projects does not compare favorably with that encountered by the Field Offices in the production of new units. However, if they are in acceptable physical condition and are properly maintained, they may provide good housing accommodations in their price range for a fairly long term.
 - (12) Major Repairs, Maintenance and Replacements. It can be expected that these projects have been maintained in good livable condition and therefore, insofar as possible, will be sold on an "as is" basis, with repairs, maintenance and replacements as provided in current project budgets being continued to the time of sale. Deviation from this policy will be considered by HUD-FHA and perhaps other agencies in the event there is a substantial amount of such items which have been deferred, or if the completion of such items or alteration is required by the local governing body.
 - (a) HUD-FHA's interest will be in assuring itself that the structures proposed for insurance will have a remaining economic life sufficiently long, and that they may be maintained in satisfactory condition at

reasonable costs over the period of remaining economic life, to appeal in the current market and to have continued marketability during the term of the proposed mortgage.

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(b) Therefore, requirements must be made for any major repairs and replacements which are now needed to make the buildings structurally sound and livable and to assure continued structural soundness, resistance to the elements and safety to the occupants. The test will be whether a prudent management would dictate immediate repair or replacement, or whether an item should be deferred, say, one or more years.

(c) The valuation process will recognize the effective age of the structures and equipment.

(13) Replacement Reserve. Reserves for Replacement will be computed utilizing the factor shown on the FHA Form 2264. The computation will be based on the cost of "Total Structures" provided by the cost analyst. Major items requiring replacement within two years will be shown separately as an additional cash requirement to the reserve fund.

(14) Protective Covenants. The ADSF/CU shall require that suitable covenants be prepared and imposed when determined to be necessary.

2-7. MORTGAGE CREDIT PROCESSING - SINGLE FAMILY.

a. Applications involving mortgages of the types described in Section 203.43(b) (1), (2), (3), (4), (5), (6), and (7) of the HUD-FHA Regulations executed in connection with properties containing not more than seven living-units may be processed under this Section 203.

b. Maximum Insurable Mortgage. The statutory, regulatory, and mortgage credit limitations under Section 203(b) are applicable with the following exceptions:

(1) When the application involves property having more than four living units the dollar limitations for a four-family unit will apply.

(2) Applications involving mortgages under Section 203.43(b)(5) may not exceed 90% of the HUD-FHA of the property.

(3) A mortgage to refinance an existing mortgage insured under the Act (provided for under Section 203.43(b) (6), and (7) may not exceed:

(a) The amount of the unpaid principal balance of the existing mortgage plus the cost of any required or proposed repairs, improvements or additions to the property, and loan closing charges, or

(b) The original principal amount of the existing mortgage. (The term may not exceed the unexpired term of the mortgage being refinanced).

c. Applications involving mortgages of the types described in Section 203.43(b) (1), (2), (3), (4), (5), and (6) (incorporated in Part 222 reference of the HUD-FHA Regulations) executed in connection with single family dwellings purchased by qualified servicemen may be in accordance with outstanding instructions for mortgage credit analysis and procedure under Section 222.

2-8. MORTGAGE CREDIT PROCESSING OF MULTIFAMILY HOUSING PURSUANT TO SECTION 223.

a. Miscellaneous Type Mortgages. Applications involving mortgages of the type defined in Section 207.31 of HUD-FHA Regulations shall be processed in accordance with the instructions for Mortgage Credit Analysis under Section 207-Multifamily Rental Housing, except as modified herein.

(1) The mortgage must cover 5 or more rental units and the amount must not exceed the lowest of the following limits:

(a) The amounts set forth for new construction under the Regulations excluding the limitation applicable to Trailer Courts or Parks.

(b) 90% of the mortgagor's total cost of acquisition.

b. Refinancing Transactions. Applications involving mortgages as defined in Section 207.31 of HUD-FHA Regulations to refinance an outstanding mortgage insured under any Section of the Act shall be processed in accordance with the instructions for Mortgage Credit Analysis under Section 207-Multifamily Rental Housing except as modified herein.

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- (2-8) (1) The mortgage shall cover 5 or more rental units and the amount and term shall not exceed the following limits:
- (a) Amount of mortgage. The mortgage amount shall not exceed the lowest of the following:
- 1 The original principal amount of the outstanding insured mortgagor, or
 - 2 90% of the HUD-FHA estimate of the value of the property or project, or
 - 3 An amount which entails a debt service (including special assessments, if any, and ground rents, if leasehold) not in excess of 90% of HUD-FHA estimate of net income, or
 - 4 The unpaid principal amount of the existing insured mortgage, plus any other outstanding indebtedness incurred in connection with capital improvements made to the property which are acceptable to the Assistant Secretary-FHA Commissioner, the cost, as determined by the Assistant Secretary-FHA Commissioner, of capital improvements, upgrading, or additions required to be made to the property, and loan closing charges, less the lower of:
 - a The amount to be escrowed for reserve items scheduled for delayed replacement, plus the cost of reserve items being replaced incident to the refinancing, or
 - b The amount of the reserve for replacement on deposit under the existing insured mortgage.
- (b) Term of Mortgage. The term of the new mortgage shall not exceed the unexpired term of the existing insured mortgage, except that in any case in which the Assistant Secretary-FHA Commissioner determined that insurance of a mortgage for an additional term will inure to the benefit of the applicable insurance fund taking into consideration the outstanding insurance liability under the existing mortgage, the new mortgage may have a term of not more than 12 years in excess of the unexpired term of the existing insured mortgage.

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Amortization shall be in accordance with the provisions in the applicable administrative instructions. See reference (1) of the Foreword.

- (2) As these mortgages are on existing properties, instructions pertaining to insurance of advances normally will not apply. Cost certification is required.

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