CHAPTER 4. SECTION 223(e) UNDERWRITING INSTRUCTIONS - HOME MORTGAGES

4-1. COST PROCESSING. There are no special cost instructions for Section 223(e).

4-2. ARCHITECTURAL PROCESSING. There are no special architectural instructions for Section 223(e).

4-3. VALUATION PROCESSING. In the following special programs, the Underwriting Report is prepared, and processing, analysis and the application of the Minimum Property Standards is in accordance with outstanding instructions for properties submitted under Section 203(b) except as set forth below.

4-4. INSURANCE IN OLDER, DECLINING URBAN AREAS - SECTION 223(e). Section 223(e) gives HUD-FHA more flexibility in providing financing under other Sections of Title II. A mortgage may be insured under any Section of Title II, pursuant to Section 223(e) for the repair, rehabilitation, construction or purchase of properties in older declining urban areas. Section 223(e) waives "economic soundness" and "economic life" requirements with respect to location and mortgage term, but it does not waive other eligibility requirements which may be imposed by the Section of the Act under which the application is submitted. It may not be used for refinancing unless coupled with major repair or rehabilitation of the property. Major repair or rehabilitation must be distinguished from maintenance and the cost of repair or rehabilitation must equal lO percent or more of HUD-FHA value.

4-5. FACTORS TO BE CONSIDERED IN APPROVING PROPERTIES PURSUANT TO SECTION 223(e). All home mortgage properties must be submitted by mortgagees under a standard Section of the Housing Act, usually Sections 203(b) or 221(d) (2). Under these Sections a property must be free of hazards, noxious odors, grossly offensive sights, or excessive noises which might endanger the physical improvements, affect the livability of the property or its marketability, or the health and safety of its occupants. A property must also comply with the code in code enforcement areas. Finally, a property must possess sufficient future economic life to warrant a long-term mortgage.

a. Examples of conditions which would render a property unacceptable under the standard Title II Sections include:

(1) Hazards. Any physical condition such as unsafe construction, danger of subsidence, flooding, unstable soils, air or vehicular traffic hazards, danger from fire or explosion, inadequate water or sewerage facilities, inadequate police and fire protection in high crime locations, radiation hazards and the like.

(2) Noxious Odors. Smoke, chemical fumes, stagnant ponds and marshes may exist to a degree that the health of occupants may be affected.

(3) Grossly Offensive Sights. These may include junk yards, truck warehouses, industrial plants, sewage disposal plants, or dilapidated abandoned properties.

(4) Excessive Noises. Noises which may affect the health and peace of mind of the occupants might include heavy industrial activity, all night cafes, bars, gas stations, truck terminals, airport activity, kennels, and the like.

b. The decision to accept or reject a property affected by any of the above cited conditions, or any other conditions must be made on a case by case basis by the processors who inspects the property and its environment to determine if the property meets the eligibility criteria and the objectives of the MPS and the location criteria.

4-6. ELIGIBILITY UNDER SECTION 223(e).

a. Section 223(e) is to be used only when a property located in an older, declining urban area cannot meet the location eligibility requirements of the Section of the Act under which insurance is sought, or produces an unreasonably short mortgage term by reason of its location in an older, declining urban area which has an adverse affect upon the economic life of the property.

b. Environment factors which render a property unacceptable because of conditions which constitute a danger to the health and safety of the occupants or to the preservation of the property as recited above are not subject to waiver under action 223(e).

4-7. LOCATION. For a location to be eligible pursuant to Section 223(e) the area must be reasonably viable and able to support adequate housing for families of lower income levels. Viability means ability to live. The location features adversely affecting the desirability and usefulness of the property must not endanger the health and safety of its occupants. They cannot be ejected to terminate the useful physical life of the property over the expected life of the mortgage. Finally the property under consideration must be considered reasonably livable and marketable in light of the alternative housing available to the typical occupant of the area despite the presence of the limiting location influences.

4-8. ACCEPTABLE RISK. A second provision of the Act concerning 223(e) eligibility is that the property must be found to be an acceptable risk. Under the standard Title II Sections a finding of economic soundness and/or acceptable risk is based upon the determination of economic life. A property with sufficient economic life to justify a long-term mortgage, which meets the property eligibility requirements is acceptable for standard Title II Sections and is, therefore, ineligible for Section 223(e). Where environmental factors so adversely affect economic life as to render the property ineligible, but the improvements are otherwise acceptable a property may be eligible under Section 223(e). The physical life of the property must be sufficient to permit the long-term mortgage. The substitution of physical life for economic life is justified because the Section 223(e) special risk provisions compensate for those environmental factors which adversely affect the property, thus permitting a mortgage of up to 30 years for single family mortgages and 40 years for multifamily mortgages if the physical life of the property will permit.

4-9. IDENTIFICATION OF ENVIRONMENTAL FACTORS.

a. When an appraiser receives an application for an appraisal and it develops that the property is located in an area that has adverse environmental factors as described in paragraph 4-5. above to the extent that rejection is proper, the application should be rejected and brought to the attention of the Chief Valuator. In rejecting conditions that render the property ineligible, the Chief Valuator will inspect the property and adjoining properties and prepare documentation including a description of the extent of the adverse factors and photos of the adverse environmental factors which cause the property or properties to be unacceptable. Care must be exercised to limit rejection only to the actual properties affected and in which it is obvious that HUD-FHA insurance would be a disservice to purchasers or mortgagors.

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b. The documented file for each specific group of properties which are similarily adversely affected must be approved by and contain the concurrence of the Director of Operations in cases of multifamily property or the Assistant Director, Single Family Mortgage Insurance and the Area Office Director or the Director and Chief Underwriter of the Insuring Office.

c. Prior approval and concurrence, the Field Office Director will contact the local municipal authorities, describe the problem encountered and request that action be taken to cause correction. If the local authorities indicate any feasible program for correction of the problem in the immediate future, the application rejection will stand until such time as correction is undertaken; the final approval, however will be withheld pending a reasonable time interval so that local authority can take action. If no action takes place after a reasonable time, the documented rejection recommendation will be sustained. (This procedure is applicable to any area including those designated for assistance (Model Cities, Urban Renewal, Code Enforcement, etc.) if not action has been or will be taken and the conditions found are unacceptable as stipulated above.)

d. The Valuator Clerk performing the initial review function should review the completed reject folder and set up an appropriate card file for future reference, logging of cases, etc. The original copy of the completed folder is to be retained in the Valuation Section Data File.

e. The instructions require identification of only those specific environmental factors which present a serious hazard to prospective occupants. This specifically does not permit any arbitrary delineation of reject areas.

4-10.CODE ENFORCEMENT AND REPAIR REQUIREMENTS.

a. The relation between HUD-FHA repair requirements and local code enforcement standards has created problems in older declining urban areas. HUD-FHA policy provides for commitment conditions assuring completion of repairs necessary to preserve the property and protect the health and safety of the occupants. This requirement reflects in a general way the intent of local housing codes, although HUD-FHA is not responsible for compliance with code requirements to the extent that local enforcement agencies are.

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b. In areas where codes are in effect and are being actively enforced, the HUD-FHA commitment should require code compliance, in which case the condition on the commitment will provide for evidence from the local code authority that the property is in compliance. In this way, HUD-FHA can protect the mortgagor of modest means from the burden of bringing a newly purchased property up to code levels. HUD-FHA appraisers in these areas should be sufficiently familiar with local code enforcement operations to reflect code-induced repairs in the property valuation.

c. The appraiser will seldom have available a breakdown of work to be done to comply with a local code. When the appraiser cannot visualize the property as it will be after completion of code work, the case may be rejected and reopened after the code enforcement inspection and receipt of the statement of required repairs. It should be emphasized that the cost of code work does not necessarily affect value in a proportional amount and that HUD-FHA requirements and code requirements may be the same or they may differ in a particular case.

4-11. FINDING VALUE. Section 223(e) will expose the valuator to marginal properties and locations in which he has seldom appraised. Such properties, however, have a value and it is the valuator's responsibility to exercise his professional judgment and skill in finding that value based upon his analysis of the property, the location and the comprehensive market data which is a prerequisite to any appraisal assignment. Care should be taken to avoid value escalations influenced principally by the availability of financing in areas where financing has previously been unavailable at reasonable market terms. Special note should be taken of sales prices which have been financed previously with sales contracts or second mortgages and appropriate downward adjustment should be made in value to reflect an all cash sale to the seller. In this manner, HUD-FHA protects the mortgagor's and Secretary's interest and at the same time broadens the choices available to the public and lessens the blight on certain properties and areas that denial of financing can impose.

4-12. REPAIRS. Commitment conditions are required to insure that repairs necessary to preserve the property and protect the health and safety of the occupants are completed. Typical repair requirements in properties of the type anticipated by this Section involve plumbing, heating systems, broken or missing fixtures, rotted counter tops and floors, leaking roofs, exterior paint peeled to the bare wood, masonry crack, and the like. A property must be in sound condition so that the mortgagor shall not have an immediate burden of maintenance and repairs. In Section 223(e) cases, the appraiser will exercise special care to specify the most economical means to the end, in realization that unnecessarily expensive corrections may jeopardize the transaction. It is, of course, recognized that some properties are in such condition that rejection is the best answer for all concerned.

4-13. MORTGAGE TERM. The maximum mortgage term for a single family commitment issued pursuant to Section 223(e) shall not exceed the remaining useful physical life of the property, assuming normal maintenance and considering any proposed rehabilitation or 30 years, whichever is less.

4-14. SECTION 203 PURSUANT TO SECTION 223. Section 203 pursuant to Section 223 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 but not more than eleven living units may be processed under these instructions.

a. Valuation procedures relative to Section 223 vary in some respects from regular 203 processing. Processing of Section 223 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

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b. The Valuation Section will participate in conferences and work closely with the ADSF/CU, and the Land Planning, Architectural and Mortgage Credit Sections during all stages.

4-15. PRELIMINARY ANALYSIS STAGE. The Valuation Section will assemble the following appraisal data in addition to other necessary data relative to the subject proposal:

a. Outline of the public agency's proposed sales plan.

b. Data relative to maintenance and operation of public rights-of-ways and utilities.

c. Tax and hazard insurance data.

d. Current rent schedules.

e. Current operating statements.

f. Waivers of local authorities covering any code or zoning violation or, in the absence of formal waivers, some reliable evidence of early availability of such waivers.

g. Proposed protective covenants which are enforceable against the property.

h. 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-way, and utility easements, if any.

i. 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.

4-16. 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.

4-17. 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 affects 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.

4-18. 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.

4-19. APPRAISAL AND ELIGIBILITY STAGE. FHA Form 2800-3 and 2017A will be used in processing as per current instructions for Section 203 processing. Since these properties may be in a different sales price and rental range from that ordinarily considered in HUD 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 construction.

4-20. MORTGAGE CREDIT PROCESSING.

a. A mortgage financing the repair, rehabilitation, construction or purchase of a property located in an older, declining urban area shall be eligible for insurance under any Section of Title II of the National Housing Act provided it meets the requirements set forth below. The mortgage shall be insured pursuant to Section 223(e).

b. Mortgage Insurance Requirement. The mortgage shall meet the underwriting criteria of the Section of the Act under which insurance is requested, except that any requirements relating to economic life and economic soundness will not apply. It must be found that:

(4-20) (1) The area is reasonably viable, considering the need for adequate housing for families of low and moderate income in the area and;

(2) In view of such consideration, the property is an acceptable risk.

c. Mortgage Credit Home Mortgage Procedures and Analysis. Follow outstanding instructions for the Section of the Act under which insurance is requested. All statutory, regulatory and mortgage credit limitations shall be applied except that the limitation on the term of mortgage of 75% of the remaining economic life of the building improvements is not applicable. In lieu thereof, a limitation of 100% of the physical life of the property will apply. Since the purpose of Section 223(e) is to make properties in older, declining urban areas eligible for insurance, waiver of FHA requirements will normally involve the property and location only. Mortgagors must meet credit, income, and minimum investment criteria pertinent to the Section of the Act under which insurance is requested.

d. Multifamily Mortgage Credit Procedures and Analysis. Follow outstanding instructions for the Section of the Act under which insurance is requested. All statutory, regulatory and mortgage credit limitations shall be applied except that the term of the loan shall not exceed 40 years or 100% of the estimated physical life of the property. Since the purpose of Section 223(e) is to make properties in older, declining urban areas as well as riot-threatened areas eligible for insurance, waiver of HUD-FHA requirements will normally involve the property and location only. Mortgagors must meet credit standards, financial requirements, and maximum mortgage criteria pertinent to the Section of the Act under which insurance is requested.