

CHAPTER 5. SECTION 223 (d)

5-1. VALUATION PROCESSING.

- a. Request for 2 Year Operating Loss Pursuant to Section 233(d). As directed by the Assistant Director Technical Services Branch/Chief Underwriter (ADTSB/CU) the Valuator will render service and assistance in support or rejection of the proposed application. Preliminary discussion, in conference with the sponsor, will develop general outlines and provide guidance to the applicant. Information supplied by the applicant will be reviewed and analyzed using data available through office records and general current working knowledge of the project and background.
- b. Upon receipt of an application and authorization of the ADTSB/CU the appraiser shall complete a narrative in memorandum for covering the following:
 - (1) City-wide Data - Present occupancy ratios pertinent to the Section of the Act project was processed under.
 - (2) Neighborhood Data.
 - (a) Income of residents.
 - (b) Age and condition of residential structures.
 - (c) Current absorption data pertaining to project.
 - (d) Current occupancy ratios.
 - (e) Competitive projects and their rentals.
 - (f) Volume of competitive constructions underway.
 - (g) Other pertinent facts having a bearing on the project.
- c. The appraiser will support his conclusions as to the forecast of continued occupancy or the rent levels predicted. The information set forth will reflect current conditions and will be prepared independently of any findings used in the original processing.

Facts and figures supplied by the sponsor are interesting only as guides and are not to be used except as they are fully substantiated by findings in the market and from unrelated sources. Comparison with similar and competing projects must be made to determine the quality and efficiency of the project management.

- (1) An accurate appraisal of the situation is required.

- (2) FHA Form 2264 - From the data gathered, FHA Form 2264 will be completed in accordance with Multifamily Reports and Forms Catalog, reference (3) of the Foreword.

5-2. MORTGAGE CREDIT ANALYSIS. Pursuant to the provisions of Section 223(d) of the National Housing Act as amended (and the applicable FHA Regulations for the Section of the Act under which the multifamily project is insured), the mortgagor may request and the Assistant Secretary-FHA Commissioner may insure a loan to cover the excess of taxes, interest, mortgage insurance premiums, hazard insurance premiums and the expense of maintenance and operation of the project over project income during the first two years following the date of completion of the project. Payments of principal in the mortgage debt are not included in calculating the excess. The loan shall be secured by an additional instrument in a form approved by the Assistant Secretary-FHA Commissioner for use in the jurisdiction in which the project is located.

- a. To be eligible for consideration for an operating loss loan, it must be found that all six of the following conditions are present:
 - (1) Two years have elapsed since the date the final project Inspection Report, FHA Form 2449, was signed by the Field Office, Chief Architectural and Engineering Section/Chief Architect;
 - (2) An allowable loss has been experienced; and
 - (3) Sustaining occupancy has been attained or there is every indication that sustaining occupancy will be attached at a predictable date in the immediate future (in most cases 18 months or less); and
 - (3) The mortgagee has assented in writing to the loan to cover operating losses; and

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- (5-2) (5) Final endorsement of the mortgage was subsequent to May 31, 1957; and
 - (6) The competence and responsibility of the project management have been established to the satisfaction of HUD-FHA.
- b. When it has been determined through preliminary discussions that all the eligibility conditions are present, a tentative estimate of the maximum loan will be made as a test of feasibility. This will be accomplished by determining the maximum insurable amount (existing mortgage and operating loss loan) that will entail a debt

service not in excess of the annual net income based on the Valuation Section's current estimate of present or projected total annual rentals and expenses assuming 90% occupancy. Calculations will be as follows:

- Step 1. Multiply the total annual rent by 90%.
- Step 2. From the amount determined in Step 1, subtract the total annual operating expenses (including reserves for replacements) taxes, annual ground rent, if leasehold, and special assessments, if any.
- Step 3. From the amount of net income determined in Step 2, deduct the amount of the current annual debt service requirements on the mortgage based on 12 times the current monthly payment for principal interest, and mortgage insurance premium.
- Step 4. The tentative maximum operating loss loan is obtained by dividing the residual income determined in Step 3 by the debt service rate for the loan based on the current interest rate and a term which normally will be the remaining term of the original mortgage. The appropriate initial curtail rate shall be obtained from FHA Form 3010. (See reference (1) of the Foreword. Multiply the monthly installments therein given by 12.

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- (5-2) c. When a formal application is made it must be accompanied by financial statement prepared by independent certified public accountants or independent public accountants in conformity with the guide lines set forth in the instructions for accountants, FHA Form 771. The statements will be reviewed jointly with the Valuation Section with particular attention to conformity with the required certification and to the consistency and plausibility of all income and expense items. Any items not recognized as an appropriate expense of the project and any items which appear excessive shall be brought to the attention of the DO/CU. Further processing shall be held in abeyance pending receipt of written instructions as to the disposition of such items.
 - d. After reconciliation of all statements, adjustments to the statements as may be necessary, and establishment of the operating loss, the maximum insurable loan shall be the lowest of the following:
 - (1) The amount of operating loss loan requested.

- (2) The amount of operating loss established.
- (3) The maximum operating loss loan based on debt service limitations.

Determine as follows and record conclusions in a memorandum to the file.

Step 1. Multiply the Valuation Section's estimate of current or projected net income by the applicable ratio of debt service to net income for the Section of the Act under which the project is insured. Where there is a 90% limitation, the percentage may be increased up to 95% if the Field Office Director believes such an increase is warranted.

Step 2. From the amount of net income determined in Step 1, deduct the amount of current annual debt service requirements on the outstanding mortgage (the same as in tentative computations).

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(5-2) Step 3. The maximum operating loss loan is obtained by dividing the residual income determined in Step 2 by the debt service rate for the loan (the same as in the tentative computation).

- e. If at the time of approval of the operating loss loan, sustaining occupancy has not been achieved, all or such portion of the loan as may be necessary shall be held in escrow to meet operating deficiencies until the project is self-sustaining. Releases of funds from the escrow in accordance with terms of the escrow agreement shall be effected only with prior approval of HUD-FHA.

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