

CHAPTER 3. ELIGIBILITY REQUIREMENTS

3-1. ELIGIBLE MORTGAGEES. To be eligible to apply for and receive commitments for mortgage insurance under any section of the National Housing Act (the Act), a lender must be an approved mortgagee. For detailed mortgagee's requirements and conditions, lender application requirements and filing instructions, see Handbook HUD 4060.1, "Mortgage Approval Handbook."

R
3-2. ELIGIBLE MORTGAGORS. The mortgagor will vary depending on the Section of the Act that the mortgage insurance application falls under.

3-3. CONTROL OF MORTGAGOR. The Secretary's control over the mortgagor will be exercised by a Regulatory Agreement, Form HUD-92466. This requirement as well as the others set forth in this chapter, will be discussed with sponsors and explained to them fully at the initial interview.

3-4. RESPONSIBILITIES AND OBLIGATIONS OF MORTGAGORS. Financing under the HUD mortgage insurance programs imposes certain responsibilities and obligations on all mortgagors. The basic description and outline material indicated below pertain to all rental housing programs. The most important of these responsibilities and obligations are:

A. Equal Opportunity in Housing. Federal law and HUD regulations require that no person, including a mortgagor or any one acting on a mortgagor's behalf, may discriminate against a person, including denying, withholding or otherwise making unavailable housing, because of race, color, religion, national origin, sex, handicap or familial status.

B. Annual Financial Statements. Mortgagors are required to keep their books and accounts in accordance with Handbook HUD-4371.1, Financial Operations and Accounting Procedures for Insured Multifamily Projects. Mortgagors also are required to provide annual financial reports meeting the requirements set forth.

C. Identity of Interest. Mortgagors are required to disclose "identities of interest." An identity of interest exists if:

(3-4) 1. The mortgagor (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor) has a financial interest in or contractual arrangement with the contractor regarding the project, including site procurement, other than the construction contract or vice versa.

2. Any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor is also a general or limited partner, shareholder, director, officer, employee or authorized representative of the contractor or vice versa.

3. The contractor advances funds for any obligation of the mortgagor, including site procurement, or pays on behalf of the mortgagor (or provides without cost) architectural or engineering services except those required by the construction contract or owner-architect agreement.

4. The mortgagor (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor) can directly or through one or more intermediaries control or influence the decisions or policies of the contractor, or the mortgagee, including apparent control or influence over the decisions or policies, or vice versa.

NOTE: "Apparent control or influence" means any relationship that exists between the mortgagor and contractor, or mortgagee (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor and contractor, or mortgagee) by blood, adoption, or marriage.

5. The mortgagor and contractor at any time enter into any agreement, contract or undertaking that changes or cancels any obligation of the other party that is required by the documents executed at initial endorsement.

6. The general contractor, subcontractor, material supplier, equipment lessor or manufacturer of industrialized housing supplies and pays, on behalf of the mortgagor, the cost of any

any architectural services or engineering services other than those of a surveyor, general superintendent, or engineer employed by a general contractor in connection with its obligations to perform work under the construction contract.

7. The general contractor, subcontractor, material supplier, equipment lessor or manufacturer of industrialized housing takes stock of any interest in the mortgagor corporation as part of the consideration to be paid.

8. Any relationship (e.g., family) exists which would give the mortgagor or general contractor control or influence over the price of the contract or the price paid to the subcontractor, material supplier or lessor of equipment.

NOTE: All questions on identities of interest or situations not covered above must be submitted in writing to HUD Headquarters, Office of Insured Multifamily Housing Development.

- R D. Working Capital Requirements. The working capital deposit shall be an amount equivalent to not less than 2 percent of the mortgage amount of the commitment.

3-5. ELIGIBLE MORTGAGES.

A. Maximum Interest Rate.

1. The interest rate is negotiated between the mortgagor and the mortgagee.

2. It may be increased or decreased only after reprocessing and issuing an amended commitment.

3. It may not be increased after initial endorsement (insurance of advances) or start of construction (insurance upon completion), except that, where a mortgage increase is requested, processed and approved, a higher (or lower) rate may be applied to the amount of the increase only.

- R B. Requirement for Level Annuity Monthly Payment (LAMP) Plan. The mortgage must be self-amortizing and provide for equal monthly payments of interest and

after project completion) under an amortization plan agreed to by the mortgagor and lender and acceptable to HUD. See Appendices 1 and 2.

R C. Mortgage Covenants. The mortgage will contain covenants which:

1. Prohibit any form of discrimination on the basis of race, sex, religion, color, national origin or familial status in connection with the occupancy of the mortgaged property.

2. Prohibit the use of the mortgaged premises for any purpose other than that for which it is intended at the date the mortgage was executed.

3. Prohibit the creation by the mortgagor of liens against the property superior or inferior to the liens of the mortgage.

4. Bind the mortgagor to keep the property insured by a standard policy or policies against fire and such other hazards as the Director may stipulate.

5. Prohibit transient housing.

R D. Mortgage Insurance Premiums. The annual mortgage insurance premium (MIP) is 0.5 percent per annum during the construction period, and 0.5 percent per annum for subsequent years, of the average outstanding principal balance of the mortgage.

3-6. MARKETABILITY - RESPONSIBILITY OF FIELD OFFICES TO AVOID CONDITIONS OF SURPLUS HOUSING.

A. HUD Obligation and Responsibility. HUD has a threefold obligation and responsibility to maintain a sound mortgage insurance operation. Foreclosures and acquisitions resulting from the overextension of building operations in a soft market are a negation of HUD responsibility:

1. To conserve HUD insurance funds and, indirectly, the funds of the United States Treasury;

2. To protect the equities that mortgagors have built up in their projects;

3. To insure sound mortgages, thereby minimizing the mortgage lender's servicing and default problems.

(3-6) B. HUD Control of Housing Supply. HUD should exercise control of the mortgage insurance program as to discourage housing oversupply. Observation of the housing market and the relationship between the supply and the demand is required of each FO, if far-reaching adverse consequences of oversupply are to be avoided.

C. Surplus Housing. It is the responsibility of the FO Director to employ those measures set out in HUD Handbook 4010.1 "Definitions, Policy Statements and General Rulings" when conditions in any part of his/her jurisdiction indicate a "soft" market or the presence of surplus housing. More importantly, the Director should use every means at his/her disposal to avoid the development of such undesirable conditions in the first place. Prevention of oversupply is better than attempting to control it after it appears.

D. Rental Housing. Consideration should be given to rental housing separate from that given to housing built for sale. It may be that a satisfactory market could exist for rental projects even though an oversupply of houses for sale is impending or exists. Conversely, a satisfactory market of houses for sale may exist even though there may be an oversupply of apartments in rental projects. Consideration also should be given to the possibility that offerings for sale in some cases may be so attractive as to pull tenants out of rental projects to a substantial degree.

3-7. PROPERTY AND DEVELOPMENT REQUIREMENTS.

S A. Project Size. Projects must consist of five or more dwelling units, which may be detached, semi-detached, row houses or multifamily structures.

B. Project Site. The project must be on one site. However, the site may consist of two or more noncontiguous parcels of land when HUD finds that the parcels:

1. Physically comprise a readily marketable real estate entity; and

2. Are within an area limited enough to allow convenient and efficient management.

(3-7) C. Real Estate Requirements. Projects must be on real estate held or to be held:

1. In fee simple; or

2.Under a renewable lease for not less than 99 years;

3.Under a lease having a period of not less than 10 years to run beyond the maturity date of the mortgage (This rule applies only to mortgages insured under Sections 220 and 234(d), which incorporate Section 201 of the NHA, and Section 221 of the NHA); or

4.Under lease executed by a government agency, or other lessor approved by HUD, for up to the maximum term the agency or lessor may enter into, but not less than 50 years from the date the mortgage is executed. (This rule applies to mortgages insured under Sections 207, 213, 231 and 232).

D.Liens.

R 1. The property must be free and clear of all liens other than the insured mortgage, except as noted in paragraph 2, below.

2.FO may permit an inferior lien made or held by a Federal, State or local government agency or instrumentality, consistent with the applicable HUD regulations and instructions found in Reference (7) of the foreword.

E.Property Standards.

1.New construction projects must comply with accepted local building codes and HUD Minimum Property Standards (MPS).

2.Rehabilitation projects must comply with local requirements if they are comparable to one of the three nationally recognized model codes.

F.Zoning. Projects, including improvements, must comply with all applicable zoning or deed restrictions.

(3-7) G. Commercial Areas. Projects must be designed primarily for residential use but may include commercial and community facilities to serve the occupants. In general, the aggregate commercial floor area may not exceed 10 percent of the gross floor area (20 percent for Section 220) of the project nor may commercial income exceed 15 percent of the estimated total gross income of the project (30 percent for Section 220).

H.Displacement. HUD's policy is to minimize displacement of tenants in its programs. Therefore, if substantial rehabilitation will cause involuntary displacement of tenants, HUD must:

1.Require the mortgagor to provide, with its application, a plan to minimize the effects of displacement.

2.The MHD will determine if the plan conforms to the Department's relocation requirements and that the mortgagor can carry out the relocation plan financially and physically.

3-8. AREA ELIGIBILITY.

A.General. HUD must consider all aspects of general livability and rentability during analysis of the location (e.g., freedom from adverse environmental conditions, accessibility to community facilities). The project location must:

1.Be acceptable for the type of housing proposed and the market to be served.

2.Meet the requirements of 24 CFR Part 50, Protection and Enhancement of Environmental Quality and Part 51, HUD Environmental Criteria and Standards.

R B. Flood Hazard Areas. HUD cannot insure in areas identified by the Federal Emergency Management Agency (FEMA) as having special flood hazards unless:

1.The community in which the project is located is participating in the National Flood Insurance Program and its regulations (see 44 CFR Parts 59-79); or

Page 3-71/95

4425.1 REV-2

(3-8) 2. It has been less than a year since FEMA's designation, and flood insurance on the structure can be obtained in compliance with Section 102(a) of the Flood Disaster Protection Act of 1973 (Public Law 93-234, 42 U.S.C. 4001 et seq.);

3.Flood Insurance is obtained as a condition of approval of the application; and

4.HUD has complied with Executive Order 11988, Floodplain Management, and, (where applicable) Executive Order 11990, Wetlands Protection.

- R C. Coastal Barriers. HUD cannot insure any project in the "Coastal Barriers Resources System" established by the Coastal Barriers Resources Act (16 U.S.C. 3501).
- R D. Military Impact Areas. HUD is prohibited from providing mortgage insurance under Title II in military-impact areas unless demand from nonmilitary households is sufficient to sustain occupancy in the insured projects and the market as a whole. Section 238(c) of the National Housing Act authorizes exceptions to the restriction when certain conditions are met.

1. Section 238(c) was implemented by a Memorandum of Understanding between HUD and the Department of Defense. Mortgages insured pursuant to Section 238(c) are obligations of the Special Risk Insurance Fund.

2. Mortgage insurance may be provided only if HUD finds that (a) the benefits to be derived from providing the insurance outweigh the risk and probable cost to the Government and (b) the Secretary of Defense certifies that there are no current plans to close the installation, or substantially reduce the personnel assigned to it.

3. The FO can process mortgage insurance applications to Military Impact Areas pursuant to Section 238(c) only upon specific approval of the Assistant Secretary of Housing after the following steps have been taken:

a. The MHD will forward the FO's recommendation and accompanying documentation from the Assistant Secretary for Housing to the attention of the Deputy Assistant Secretary for Multifamily Housing.

1/95

Page 3-8

4425.1 REV-2

(3-8) b. Projects in military impact areas. A project located in a military impact area, as determined by HUD. A military impact area is generally a small or medium size metropolitan housing market area or a remote or isolated nonmetropolitan area where:

(1) Military-connected households comprise 25 percent or more of the total households in the market area. Military-connected households include active duty military personnel, civilian employees of the military service (Department of Defense) or other

Federal agency at or in support of the installation, and employees of contractors and sub-contractors directly associated with the military installation, and their dependents. Unaccompanied active duty military personnel housed in military-controlled group quarters housing (barracks, BOQ's) are excluded; and

(2) There is concern about the continued stability of the current level of military strength and mission at the installation based on public announcements from the Department of Defense or the military service of impending changes; and

(3) The complete reduction of military-connected households living in nonmilitary rental housing over a 5 year period, at an annual average decline of 20 percent, would, taking into account growth in the civilian economy and normal changes in the housing inventory, cause an adverse impact on the private rental market resulting in an increase in the rental vacancy rate in the housing market of 10 percent at the end of that period.

4. The Office of Housing, with consultation from the Office of Policy Development and Research, will review the request and recommend to the Assistant Secretary for Housing whether to designate the area as a Military Impact Area.

Page 3-91/95

4425.1 REV-2

(3-8) 5. The Office of Housing will notify the FO of the decision and whether it can proceed to offer mortgage insurance in the area under Section 238(c).

3-9. REQUIREMENTS OF GENERAL CONTRACTORS.

A. Prevailing Wages. The National Housing Act requires:

S 1. Payment of no less than the wages prevailing in the locality as predetermined by the Secretary of Labor pursuant to the Davis-Bacon Act (40 U.S.C. Section 276a-276a-5), to all laborers and mechanics employed in the construction (including rehabilitation) of any project, and

2. Compliance with all other related rules and regulations

under Davis-Bacon (See paragraphs 5-10, 11-2, and 13-6 and Handbook 1344.1, Federal Labor Standards Compliance in Housing and Community Development Programs) and the Copeland Act (40 U.S.C. Section 276c).

R B. Equal Employment Opportunity. HUD must comply with Executive Order 11246 and 41 CFR Part 60 regarding equal employment on Federally-assisted construction contract. They:

 1.Prohibit discrimination because of race, color, religion, sex or national origin.

 2.Require affirmative action to ensure fair treatment on: employment, upgrading, demotion or transfer; recruitment or recruitment advertising; layoff or termination; rates of pay or other forms of compensation; and selection for training and apprenticeship.