

CHAPTER 10. REHABILITATION

10-1. CRITERIA FOR ACCEPTANCE OF REHABILITATION PROPOSALS. The test of the acceptability of an application for financial assistance for rehabilitation is the soundness of the proposed rehabilitation project, the promise it holds for sustaining the physical and social upgrading proposed to be achieved, and the reasonableness of the risks inherent in the transaction. Among the factors to be considered in judging the acceptability of a rehabilitation proposal are:

- a. Are the structures suitable for rehabilitation to a reasonable standard of livability and safety at rents within the paying capacity of the income group for which the housing is to be produced?
- b. Is the proposed rehabilitation project of sufficient size to give reasonable promise that the upgrading will be sustainable?
- c. Does the sponsor have the capacity to provide effective, sympathetic, socially-oriented management?
- d. Are open space and public facilities adequate?
- e. Are relocation requirements adequately provided for by the sponsor or public agency?

10-2. "AS IS" VALUE IN MULTIFAMILY REHABILITATION. "As Is" Value will be the lesser of Fair Market "As Is" Value or the "As Is" Value by the Residual Approach.

The Fair Market Value "As Is" by the market approach will be based upon the going market price for comparable properties in similar condition to the property being appraised. Thus, if comparable properties in similar condition are available for \$4,000 per unit, for example, there is no justification for finding a value "as is" in any amount substantially in excess of \$4,000 per unit.

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10-3. PROCESSING - PROPERTY TO BE ACQUIRED. The "As Is" Value and the Total Estimated Cost of Project (Items 72 and 73, Section G of the FHA Form 2264) will be completed as follows:

- a. An appraisal of the project "as is" will be made on a supplemental FHA Form 2264 titled, "Fair Market 'As Is' Value," using Sections A, B, C, D, E, F, I, J (Items 12 and 13 only), K and L (excluding the summation estimate).
- b. Use the applicable Replacement Cost Format (Reference 1) to find the total estimated project cost. Use the Market "As Is" Value from Step (a) and the rehabilitation cost received from the cost analyst, which is based on the sponsor's cost estimate, and available internal data.

- c. Find the maximum supportable cost of the project after rehabilitation. This will require a determination of a debt service maximum supportable cost. In Section 207, the maximum is also limited by value.
- d. If the total estimated project cost from Step (b) does not exceed the maximum supportable cost from Step (c), the Residual "As Is" value of the project will equal the Market "As Is" value from Step (a).
- e. If the total estimated project cost from Step (b) is greater than the maximum supportable cost from Step (c), this indicates that the "as is" value by the residual approach will be lower than the market "as is" value. Complete the "Residual As Is Value Format" for property to be acquired (See Reference 2 of the Foreword).

Complete Section G of FHA Form 2264 using the "Residual As Is Value." You will notice that the total project cost, Line G-73, will equal the supportable cost or value found in Step (c).

- 10-4. PROPERTY OWNED. Where the project has been owned by the sponsor in excess of one year, the "as is" value will be determined in the same manner as for a property to be acquired. However, existing indebtedness is used in the interest calculation in place of the "as is" value for properties owned. This requires the use of a special format in Step 3(e) titled, "Residual As Is Value - By Formula - Rehabilitation Projects (Property Owned)" if a residual approach is required (See Reference 2 of the Foreword).

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In any case, once the "as is" value has been determined (by procedures described in paragraph 10-3.a. through 10-3.e. above), a check must be made to determine whether existing indebtedness will limit the mortgage. The procedure is as follows:

- a. Subtract the existing indebtedness from the "As Is" Value. The result is the sponsor's equity.
- b. If the sponsor's equity exceeds 10% of the lesser of the total estimated cost from Step 10-3.b. or the maximum supportable cost (or value) of the project from Step 10-3.c., the project mortgage must be determined by completing the applicable format titled, "Maximum Mortgage - By Formula - Rehabilitation Projects - Property Owned - When Existing Indebtedness Controls." (See Reference 2 of the Foreword.)

Complete Section G of FHA Form 2264 based upon the mortgage indicated using the "as is" value in Line G-72. The existing

indebtedness, although limiting the mortgage, is never entered in Line G-72.

- c. If the sponsor's equity is less than 10% as determined in Step 10-4.b., the project mortgage will be 90% of the lower of the estimates in Steps 10-3.b. or 10-3c. In this event, the format for "Maximum Mortgage - By Formula" will not be needed and would produce a wrong answer if completed.

When part of the property is owned (for more than 12 months) and part is to be acquired, process the part owned and the part to be acquired as though they were separate projects. Then add the corresponding items of project cost, rents, expenses, etc., to obtain figures for the composite FHA Forms 2264 and 2264A required to validate the single mortgage transaction.

#### 10-5. RESERVES.

- a. Contingency Reserve. For the purpose of providing for unanticipated costs, which are inherent in the rehabilitation of older structures, there will normally be included in the mortgage amount a reserve for contingencies. The reserve is based upon the percentage of estimated rehabilitation cost without fees (the sum of lines 36C, 41 and 42 of Part G, FHA Form 2264). It may range from 0 to 10% depending upon the job conditions and the experience and

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financial ability of the sponsor, the mortgagor and contractor. In determining the amount of the contingency reserve, judgment should be made on whether the contractor's bid already contains an adequate reserve for contingencies. This percentage is included as a separate item in the estimate and is to be entered in Line 70, Part G of PHA Form 2264. \*

- b. The reserve may be used to cover unforeseen costs of construction as well as unanticipated financing costs occasioned by delays in construction, etc. The reserve may not be used to provide additional profit or fees to the architect, attorney, or other principals involved. The reserve may not be utilized to defray the expense of unwarranted or luxury items caused by changes in construction or substitution of materials or equipment.
- c. The contingency reserve is included in the mortgage amount and its disbursement is controlled by the Mortgage Credit Section in FHA Form 2451, Financial Record of Mortgage Loan Transaction. No advances from the reserve may be made by

the mortgagee prior to and without the advance written consent of the Field Office Director. At final endorsement, the amount of the mortgage is to be reduced as necessary by the unused amount of the contingency reserve, as reflected by the certification of actual costs. However, if the acquisition cost of the property exceeds the HUD-FHA finding of "as is" value by a residual approach, any portion of the contingency reserve not used at cost certification may, in lieu of reducing the mortgage amount, be applied to the purchase of the property. The amount of unused reserve funds so applied plus the residual "as is" value may in no case exceed the actual purchase price of the property or the fair market "as is" value, whichever is lower. \*

10-6. RESERVE FOR REPLACEMENT.

- a. A reserve for replacements is not required for rehabilitation projects containing eight living units or less under a separate mortgage. The sponsor will not be permitted to divide his application into separate projects of less than nine units if his intent appears to be evasion of the reserve for replacements requirement.

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- b. Although funding of a reserve account is required only for projects of more than eight units, the reserve for replacements is calculated in all cases, as 0.004 of the mortgage amount, and is included as part of the annual operating expenses.

10-7. INTEREST DURING CONSTRUCTION. Interest during construction will be calculated based on the sum of one-half of the mortgage plus one-half of either the "As Is" value (property to be acquired) or existing indebtedness (property owned). \*

10-8. INSPECTION FEE. The inspection fee is calculated at 0.5% on the total for all improvements (plus BSPRA if applicable) rounded to the next higher \$100 multiple. \*

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