CHAPTER 4. APPLICATION PROCESSING

4-1. OVERVIEW. The purpose of processing under Section 223(a)(7) is not to reunderwrite the project as if it were a new project. These mortgages to be refinanced are already in HUD's insured portfolio and the goal is to improve their financial and physical condition and, therefore, HUD's security. The level of review will be dictated by the specifics of each case. For example, if a portion of the repair and closing costs cannot be fully covered by mortgage proceeds, evidence of financial capacity would be required. On the other hand, straightforward financial transactions should be processed with the fewest steps possible.

4-2. PROJECT NUMBERING. Projects should be numbered with the next number under the same Section of the Act under which the project was originally insured. Production method should be input as Code 6 (223(a)(7)) in the MIPS database. Previously coinsured projects (number series 94000) should be numbered in a similar manner (e.g., the next Section 221(d) number if the project was originally a Section 221(d) project). However, it is important that HUD be able to track what has happened to the coinsurance portfolio. Therefore, it is essential that the superseded 94000 number be maintained in the MIPS database.

4-3. TECHNICAL PROCESSING. Process a refinancing transaction as follows:

A. Architectural, Engineering and Cost staff must inspect the project to determine that the project is in satisfactory condition and has been properly maintained. Requirements may be made on the commitment concerning necessary repairs and improvements. The repair list should specify critical and noncritical repairs (if any). Noncritical repairs may be completed after endorsement in accordance with Chapter 6. Lead-based paint requirements and testing and abatement (which are eligible costs) are covered in Handbook 4460.1 REV-1, paragraph 1-40. The scope of repairs must also be reviewed by Loan Management. Cost staff must prepare an "as new" replacement cost and a supplemental cost estimate for any required repairs. See instructions in Handbook 4565.1 for Section 223(f) projects.

(4-3) B. Valuation staff must determine the project's value in order to ensure that the 90 percent of value criterion is not exceeded (see paragraph 2-2A). Use the procedures in Handbook 4565.1 for Section 223(f) projects.

C. Mortgage Credit must determine that the income is sufficient to meet all expenses and the debt service of the new mortgage. Mortgage Credit must also analyze the existing debt to determine its acceptability for inclusion in the refinanced mortgage. Unsecured debt will not be considered unless it is reflected in the audited financial statements.

D. Loan Management (LM) will provide the Director of Housing Development recommendations addressing housing management concerns as follows:

1. LM must review the operating expenses, income, occupancy levels, existing debt, and proposed repairs for acceptability. LM will also review the adequacy of the reserves, including the reserve for replacements, and advise on any required additional payments to the reserves to be made as a condition of the commitment.

   For the replacement reserve, this is generally a minimum of 2 years' need. Funds must be provided at closing if there is less than 2 years' need in the reserve for replacements and insufficient mortgage proceeds at closing to fund the reserve at an adequate level. The need to increase the monthly deposit to bring the reserve to an adequate level will also be addressed by LM.

2. LM must determine before commitment that any audit findings or deficiencies have been resolved.

3. If a project is receiving rent subsides, and if refinancing will result in a reduction of debt service payments, the amount of rent subsidy must be recalculated. Section 142 of the Housing and Community Development Act of 1987 required such recalculation for Section 8 projects that are refinanced in a manner that reduces periodic payments to the owner.

(4-3) (D3) When financing lowers the debt service, the Section 8 Contract rents should be reduced for assisted units in accordance with Office of Housing Management procedures. However, LM may permit owners to retain a portion of the savings not to exceed 10 percent of the Section 8 savings as an incentive to refinance. In addition, State and local tax-exempt bond issuers are permitted by the McKinney Act to keep a higher level of savings (up to 50 percent).