

# Section I Handbook Introduction

## Chapter 1 Introduction

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### 1.1

### Purpose of the Section 232 Handbook

The Section 232 Program is a Federal Housing Administration (FHA) mortgage insurance program that insures HUD-approved Lenders against financial loss from mortgage defaults. The program was re-engineered in 2008, developing its LEAN process, which is a model to provide exceptional customer service, reduce processing time, and streamline operations to reduce risk to the FHA fund. The LEAN process, a process emphasizing continuous improvement, relies on the Lender to be responsible for the preparation of the application for mortgage insurance, for requests during servicing (e.g., for a change of participants) and for making recommendations to HUD based upon the Lender's processing/analysis and the program requirements. HUD reviews the Lender's submissions and makes the final underwriting decision. Representations contained in the Lender's submissions are subject to further review when HUD deems it is warranted to protect against risk to the FHA.

This Handbook establishes uniform national standards for applying, underwriting, submitting for approval, closing, managing and servicing mortgages insured or held pursuant to Section 232 of the National Housing Act. Section 232 mortgage insurance is available on mortgages that finance residential healthcare facilities, such as, nursing homes, assisted living facilities and board and care facilities. Eligible mortgages can be for the purchase, refinance, new construction, or substantial rehabilitation – or for a combination of these. Section 232 may also be used to insure mortgages to install fire safety equipment in such properties.

HUD's Office of Healthcare Programs (OHP), and specifically the Office of Residential Care Facilities (ORCF) within OHP, has responsibility for administering the Section 232 mortgage insurance program.

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0605. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

## 1.2

## Handbook Sections

In addition to this introductory section (consisting of this chapter and a chapter on Lender Relations), there are two primary sections of this Handbook. Those are the Production section and the Asset Management section.

- A. **Production.** The Section 232 Production section ([Section II](#)) provides mortgage insurance program descriptions, Borrower and Lender eligibility requirements, application requirements, underwriting standards and construction loan administration requirements. It also provides approved Lenders the instructions to prepare, process and submit loan applications for residential healthcare facilities financed for FHA mortgage insurance.
- B. **Asset Management.** The Section 232 Asset Management section ([Section III](#)) is designed to establish national standards for the servicing and risk management of Section 232 FHA-insured mortgages. The section also describes how each Account Executive (AE) works in partnership with the Borrower and Lender to ensure each FHA-Insured 232 mortgage is financially and operationally strong, that each property provides a safe, quality place of residence, and that the loan remains viable for the term of the mortgage.
- C. Across all sections of this Handbook, the term “Lender,” when used in a loan servicing context, means the primary servicer of the mortgage loan, whether such party is the mortgage holder or third-party servicer. Servicers are responsible for their actions in servicing FHA-insured mortgages, including actions taken on behalf, or at the direction, of the mortgage holder. A mortgage holder remains responsible for all servicing actions, including the acts of its servicers.

## 1.3

## Legal Authority

- A. **Section 232:** The Section 232 Program is authorized by Section 232 of the National Housing Act (12 U.S.C. 1715w), (12 U.S.C. 1715(b)) and 42 U.S.C. 3535. Statutory authority for the implementation of the Section 232 programs is contained in the basic insuring authority for each of the Section 232 programs. See the National Housing Act, Sections 223(a)(7), 232, 223(d), 232/223(f), and 241. Additionally, Section 211 of the National Housing Act authorizes and directs the Secretary to make such rules and regulations as may be necessary to carry out the provisions of the Act. Regulatory authority includes 24 CFR Parts 200, 232 and Section 5.801.
- B. **Section 232/223(f):** Section 223(f) of the National Housing Act was added by Section 311(a) of the Housing and Community Development Act of 1974 and is codified at 12 U.S.C. 1715n(f). The program regulations are found in 24 CFR, Parts 200 and 232.
- C. **Section 232/223(a)(7):** The Section 232/223(a)(7) program is authorized by the National Housing Act (12 USC 1715n(a)(7)).

- 84 D. **Section 232/241(a):** The Section 232/241(a) program is authorized under the National  
85 Housing Act, as amended, Section 241, Public Law 90-448 (12 U.S.C. 1715) and Public Law  
86 94-375 (12 U.S.C. 1715z-6(a)). The program regulations are found in 24 CFR Parts 200 and  
87 241.  
88
- 89 E. **Section 223(d):** The Section 223(d) Operating Loss Loan program is authorized by Section  
90 223(d) (12 U.S.C. 1715n(d)) of the National Housing Act 1937, as amended; Public Law 90-  
91 448, as amended; and Public Law 91-152, 12 U.S.C. 1715x. The program regulations are  
92 found in 24 CFR 207.  
93
- 94 F. **Section 232(i):** The Section 232(i) program is authorized under the National Housing Act  
95 (12 U.S.C. 1715w(i)) as amended; Section 203(i) Public Law 93-204. The program  
96 regulations are found in 24 CFR Part 232 Subpart C.  
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## 1.4

### Relation of Section 232 Handbook to Other Guidance

100 This Handbook is intended as a comprehensive guide to the Section 232 Program, and  
101 supersedes prior handbook or other guidance specifically on the Section 232 Program, consistent  
102 with statutory and regulatory requirements. Handbook chapters may include appendices which  
103 list the most recently published transactional documents, but the Handbook also covers  
104 transactions for which earlier versions of the documents were used and are in force. There may  
105 also be instances where existing guidance (particularly related to Borrower audited financial  
106 statement matters), references “Multifamily Housing”, because the guidance was issued at a time  
107 when the Section 232 Program was a part of the Office of Multifamily Housing, and thus is still  
108 applicable to Section 232 ~~Projects~~projects. If a particular Section 232 program matter is not  
109 addressed in this Handbook, and appears in other guidance, questions regarding applicability  
110 may be raised with ORCF.  
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112 This Handbook is part of “Program Obligations,” a term used in multiple controlling documents  
113 and also at various places in this Handbook. “Program Obligations” means (1) all applicable  
114 statutes and any regulations issued by HUD pursuant thereto that apply to the ~~Project~~project,  
115 including all amendments to such statutes and regulations, as they become effective, except that  
116 changes subject to notice and comment rulemaking shall become effective only upon completion  
117 of the rulemaking process, and (2) all current requirements in HUD handbooks and guides,  
118 notices, and mortgagee letters that apply to the ~~Project~~project, and all future updates, changes  
119 and amendments thereto, as they become effective, except that changes subject to notice and  
120 comment rulemaking shall become effective only upon completion of the rulemaking process,  
121 and provided that such future updates, changes and amendments shall be applicable to the  
122 ~~Project~~project only to the extent that they interpret, clarify and implement terms in ~~this~~  
123 ~~Agreement~~the existing controlling documents of the project rather than add or delete provisions  
124 from such ~~document~~documents. Handbooks, guides, notices, and mortgagee letters are available  
125 on HUD’s official website:  
126

127 [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/administration/hudclips](http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips) or a

128 successor location to that site. [Email Blasts and FAQs may provide additional clarification to](#)  
129 [existing policies and are also available on the website.](#)

## 1.5

## Waivers of the Section 232 Handbook

132 This Handbook provides instructions to Lenders on how to apply, underwrite, close and service  
133 232 insured mortgages consistent with program-related regulatory requirements and other  
134 directives. However, there are situations where Lenders are fully aware of ORCF's program  
135 requirements, but have legitimate business reasons for seeking loans for projects that do not fully  
136 meet ORCF's published guidelines. In those circumstances, the Lender must apply for a waiver  
137 of the program requirement, in advance of the transaction's approval. During the course of  
138 ORCF's review of a Lender's application, it may also be determined that a waiver is needed to  
139 obtain or maintain section 232 insurance. In either case, ORCF sets a high standard to approve  
140 program waivers.  
141

142 There are two types of waiver requests: Regulatory waivers and Housing Directive waivers.  
143 Regulatory waivers are issued to waive a rule that is published in Title 24 of the Code of Federal  
144 Regulations. Generally, rules are established pursuant to statutory authority or by publication in  
145 the Federal Register for notice and comment. Regulatory waivers can only be approved by the  
146 FHA Commissioner. Housing Directive waivers are issued to waive handbook provisions,  
147 Mortgagee Letters and other directives issued by the program office. Housing Directive waivers  
148 are approved by OHP management under provisions determined by HUD— and may be  
149 requested using the Request for Waiver of Housing Directive - Residential Care  
150 Facilities/Section 232 (Form HUD-2-ORCF). This form is not applicable to regulatory waiver  
151 requests.  
152

153 Waiver requests are project specific. A Lender must follow the waiver provisions that are  
154 prescribed in its application process. If the waiver request is not associated with an application  
155 or not prescribed, the Lender should send the following information to the HUD Underwriter or  
156 Account Executive assigned to the project:  
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- 158 A. Project Name,
- 159 B. Project Address,
- 160 C. FHA Number,
- 161 D. Type of Facility,
- 162 E. Number of beds,
- 163 F. Number of units, and
- 164 G. Full explanation and supporting documentation on why the project cannot meet the  
165 program requirements.  
166

167 It is also important to remember that statutory provisions may not be waived unless expressly  
168 permitted by statute. Generally, statutory requirements in the areas of fair housing, civil rights,  
169 environmental protection, and labor standards may not be waived.  
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## 1.6

## Identity of Interest (IOI)

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174 In processing and reviewing applications for FHA-insured mortgages, and in ensuring the long-  
175 term viability and ongoing programmatic compliance of FHA-insured projects and their  
176 members of the development team, ~~operators~~Operators, and investors pursuant to Section 232 of  
177 the National Housing Act, ORCF analyzes the relationship between and among entities. ORCF  
178 analyzes relationships in order to determine if one entity *could* significantly influence another  
179 entity to an extent that one or more of the entities party to a project-related transaction might be  
180 prevented from fully pursuing its own separate interests. In its analysis of the relationships  
181 between and among entities, HUD will determine whether any relationship would reasonably  
182 give rise to a presumption that the parties may not operate at arm's length. When it is  
183 determined that a relationship between or among the proposed parties constitutes an identity of  
184 interest, the transaction may not proceed (e.g., a transaction involving an IOI between an FHA  
185 Lender and Borrower, per par. 1.6.C.1.a below) or may be subject to additional requirements  
186 and/or certain restrictions ~~will apply~~.

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188 A. Definition. An “**Identity of Interest**” (whether or not such term is capitalized) is any  
189 relationship based on family ties or financial interests between or among two or more entities  
190 involved in a project-related transaction which reasonably gives rise to a presumption that the  
191 entities ~~may~~might not operate at arms-length. These project-related transactions include, but  
192 are not limited to:

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- 194 1. Establishing the purchase price of the property,
- 195 2. Establishing the cost of the design, rehabilitation or construction (or influencing the
- 196 performance of entities charged with carrying out such work),
- 197 3. Establishing the terms of the financing,
- 198 4. Controlling the funds, ~~or~~
- 199 5. Providing legal, consulting or management services ~~,~~ or
- 200 6. Establishing project valuation.
- 201

202 B. Application. An identity of interest shall be deemed to exist between two entities if:

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- 204 1. An entity, or any Owner of any direct or indirect ownership interest of such entity, or
- 205 any family member of any such Owner, is:
  - 206 a. an Owner of any direct or indirect interest in the other party, or
  - 207 b. an officer, director, stockholder, partner, trustee, manager or member of such
  - 208 other party; or
  - 209
- 210 2. Any officer, director, stockholder, partner, trustee, manager, member, principal staff,
- 211 contract employee or consultant of an entity, or any family member of any such
- 212 officer, director, trustee, stockholder, partner, trustee, manager, principal staff,
- 213 contract employee or consultant, is:
  - 214 a. an Owner of any direct or indirect interest in the other party, or
  - 215 b. an officer, director, stockholder, partner, trustee, manager or member of such
  - 216 other party.
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- 218 3. A “family member,” as used herein, means, with respect to any person, his/her  
219 spouse, parents, siblings, children, grandparents, grandchildren, aunts, uncles,  
220 mother-in-law, father-in-law, brothers-in-law and sisters-in-law.  
221
- 222 C. Determinations. The definition of “identity of interest” is generally applicable to HUD’s  
223 determination of the appropriateness of relationships between and among parties involved in  
224 the financing, development and operation, management and ownership of the project. HUD  
225 concerns itself with the relationship between and among entities involved in project-related  
226 transactions throughout the development and asset management processes. Due to the  
227 inherent complexity of identity of interest determinations, additional guidance on the  
228 determinations made and what additional requirements or restrictions are applicable when  
229 involving various types of entities is provided in the appropriate chapters.  
230
- 231 1. **Identities of interest addressed in this Handbook.** Identities of interest involving  
232 the following parties are addressed in this Handbook:  
233 a. Lenders (FHA Lender) (see Introduction, Chapter 2),  
234 b. Lenders (Existing Lender, Bridge Lender, and Mezzanine Lender) (see  
235 [paragraph 1.6.C.4 below and](#) Production, Chapter 3)  
236 c. Borrowers, Buyers and Sellers (see Production, Chapter 3)  
237 d. Accounts Receivable Lenders (see Production, Chapter 15)  
238 e. Architects (see Production, Chapters 10 and 11)  
239 f. Contractors (General Contractors, Subcontractors, Suppliers) (see Production,  
240 Chapters 10 and 11)  
241 g. Operators and Management Agents (see Production, Chapter 8 and Asset  
242 Management, Chapter 8)  
243 [h. Appraisers \(see Production, Chapter 5\)](#)  
244
- 245 2. **Establishing the purchase price of the property.** HUD defines an identity of  
246 interest purchase as a transaction in which there is a relationship of any degree  
247 between the seller and purchaser (or any affiliates or principals of any such entities)  
248 that survives the transaction and could be construed to not be arms-length. These  
249 transactions include instances where a partner is being bought out, but may not  
250 necessarily include sale-leaseback transactions (see Production, Chapter 2 & 3).  
251
- 252 3. **Establishing the cost of the design, rehabilitation or construction (or influencing  
253 the performance of entities charged with carrying out such work).**  
254 a. Relationships between the architect and the Borrower, general contractor or  
255 subcontractor are discussed in Production, Chapter 11.  
256 b. Rules pertaining to Cost Certification (see Production, Chapter 11) are  
257 impacted when there is an identity of interest between or among:  
258 i. The Borrower and the general contractor, or  
259 ii. The Subcontractor and the Borrower, general contractor, another  
260 subcontractor, equipment lessor or material supplier  
261 c. HUD requires the FHA Lender (Lender) to assess a Borrower’s previous use  
262 of a contractor when an identity of interest is involved (see Production,  
263 Chapter 10).

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4. **Establishing the terms of the financing.**

- a. The Lender (and any affiliates or principals) cannot have an identity of interest with the Borrower (and any affiliates or principals). The Lender (and any affiliates or principals) also cannot have an identity of interest with a sponsor, general contractor, subcontractor or the seller of a particular transaction (see Introduction, Chapter 2).
- b. See Production, Chapter 12.2.E for guidance on how to process applications involving an identity of interest between the Lender and a tax credit equity syndicator or an investor.
- c. HUD also examines relationships between and among other Lenders involved in various aspects of the project:
  - i. In the case of existing indebtedness created with an identity of interest between the Borrower and the current Lender in a banking relationship, where a third-party lender submits the firm application, a Debt Investigation is always required (See Production, Chapter 3).
  - ii. Subject to paragraph 1.6.C.4 below, Bridge Lenders may have an identity of interest with the Lender, and an existing Lender may engage an identity of interest Lender in taking out a bridge loan of this debt. However, in both instances, HUD will require the Lender to disclose the relationship and to carefully justify the concluded valuation (see Production, Chapter 3).
  - iii. Mezzanine Lenders may not have an identity of interest with the principals of Borrower, but may have an identity of interest with the existing Lender, subject to the same scrutiny as Bridge Lenders (see Production, Chapter 3).
  - iv. In the case of bond financed transactions, a financing fee beyond 3.5% will not be recognized where an identity of interest is involved between the sponsor or Borrower and a Lender (see Production, Chapter 3).
- d. An FHA Lender may only proceed with an application involving a refinance of a loan held by an IOI Bridge Lender subject to the following:
  - i. The Bridge Lender did not provide below-market terms for the Bridge/Balance Sheet Loan as an inducement to the Borrower to close the FHA loan with the IOI FHA Lender.
  - ii. Neither the Bridge Lender nor the FHA Lender conditioned their involvement on, or offered any incentives for, involving the other IOI lender in any financing for the project.
  - iii. The underwriting of the FHA loan on the Project is in no way influenced by the Bridge Lender, and appropriate firewalls will remain in place at all times during the FHA transaction.
  - iv. Bridge loan underwriting was completed independently of the FHA Underwriting, including separate underwriting teams/staff.
  - v. Neither the Bridge Lender nor the FHA Lender will have any involvement in, or responsibility for, the day-to-day operations of the Project.

- 310                    vi. The Lender understands and agrees that borrowers may look at  
311                    multiple take-out sources, and that refinancing via FHA will not be  
312                    mandated or improperly induced with offers such as forgiveness of  
313                    fees or other such favorable terms.  
314                    vii. In the application the FHA Lender affirmatively represents that the  
315                    above-stated conditions are met.

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317 **5. Controlling the funds.**

- 318                    a. When accounts receivable (ARA/R) financing is involved, any identity of  
319                    interest involving the ARA/R Lender must be disclosed, analyzed and  
320                    mitigated if it is determined that a potential conflict of interest is present (see  
321                    Production, Chapter 15).  
322                    b. Additional requirements and restrictions may apply when various other  
323                    identities of interest exist (e.g., between the Borrower and the Operator,  
324                    Management Agent and/or Lessee/Tenant).

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326 **6. Providing legal, consulting or management services.**

- 327                    a. In the Opinions of Borrower's and Operator's Counsel (Form HUD-  
328                    9127591725-INST), an attorney signing the Opinion cannot have any identity  
329                    of interest with any party to the transaction. If another member of the firm has  
330                    an interest in any entity involved in the transaction, such a relationship must  
331                    be disclosed. Additionally, attorneys that represent both the Borrower and the  
332                    Operator must disclose to both parties the inherent conflicts of interest  
333                    involved. HUD further expects that there will be no conflict of interest  
334                    between the Lender's Counsel and Borrower's Counsel in the subject  
335                    transaction.  
336                    b. Fees arising from pre-opening management services provided are not included  
337                    as a mortgageable cost if an identity of interest exists between the Borrower  
338                    and the service provider (See Production, Chapter 2).  
339                    c. Any identity of interest between a prospective risk management provider and  
340                    the Borrower, Lessee or Lender must be disclosed and analyzed (see Asset  
341                    Management, Chapter 5).

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343 **7. Establishing Project Valuation. See Section II, Production, Chapter 5.2 for**  
344 **more details.**

- 345  
346 D. Conflict of Interest. HUD Regulations for general ~~lender~~Lender approval (24 CFR §202.5(1))  
347 include the following prohibition of conflicts of interest:

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349                    *Conflict of interest and responsibility.* A mortgagee (Lender) may not pay  
350                    anything of value, directly or indirectly, in connection with any insured mortgage  
351                    transaction or transactions to any person or entity if such person or entity has  
352                    received any other consideration from the mortgagor, seller, builder, or any other  
353                    person for services related to such transactions or related to the purchase or sale of  
354                    the mortgaged property, except that consideration, approved by the Secretary,

355 may be paid for services actually performed. The mortgagee shall not pay a  
356 referral fee to any person or organization.

357  
358 In its analysis of relationships between and among parties to project-related  
359 transactions and Lenders, HUD will examine identities of interest, in part, to  
360 determine if they result in a conflict of interest. When a conflict of interest is  
361 determined to exist, certain prohibitions or additional risk mitigation may be required.

362  
363 [NOTE: See Introduction and Production Chapter 15, for specific discussions of  
364 conflicts of interest involving Lenders and ARA/R financing situations.]

- 365  
366 E. For publicly-traded ~~lenders~~Lenders (or ~~lenders~~Lenders owned by publicly-traded  
367 companies), the Borrower must provide to the Lender and HUD a certification that there  
368 is no identity of interest between Borrower (and any affiliates or principals) and the  
369 Lender (and any affiliates or principals). For purposes of complying with the IOI  
370 requirements of this handbook, publicly-traded Lenders (or ~~lenders~~Lenders owned by  
371 publicly-traded companies) may rely on such Borrower certification in determining its  
372 satisfaction with said IOI requirements  
373