



ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

**Date:** September 16, 2025

**Mortgagee Letter:** 2025-20

**To:** All FHA-Approved Section 232 Mortgagees

**Subject:** Updates to Definition of “Substantial Rehabilitation” in the Section 232 Program

**Purpose:** This Mortgagee Letter amends the definition of “Substantial Rehabilitation” as contained in the Healthcare Mortgage Insurance Handbook, 4232.1, Rev. 1 (“Section 232 Handbook”).

**Effective Date:** This Mortgagee Letter is effective immediately as to all applications submitted on or after September 16, 2025.

## **I. Background**

The Section 232 Program has long provided a mortgage insurance vehicle for new construction and substantial rehabilitation of residential care facilities. For many years, the definition of “Substantial Rehabilitation” for the Section 232 Program has been contained in Section II – Production, Chapter 2, Section 2.6.B of the Section 232 Handbook. That definition has been comprised of two alternative elements; Section 2.6.B states that a project “qualifies as a substantial rehabilitation project” when:

1. The hard costs of repairs, replacements, and improvements (not including major movable equipment) exceeds 15% of the project’s value after completion of all repairs, replacements, and improvements. Additions are permitted in substantial rehabilitation projects, but the costs of the addition are not included in the eligibility test; **OR**
2. Two or more major building components are being substantially replaced. The component must be significant to the building and its use, normally expected to last the useful life of the structure, and not minor or cosmetic. Substantially replaced means that at least 50% of the component must be replaced. Examples of major building components are: roof structures, wall or floor structures, foundations, plumbing, central heating and air conditioning systems, and electrical systems. Examples related to a roof replacement include major building components such as roof sheathing, rafters, framing members; and examples of minor building components include shingles or built-up roofing.

When this definition was placed in the Section 232 Handbook, much of it was brought over from the MAP Guide then in effect. The MAP Guide’s definition has long since been updated; the definition applicable to the Section 232 Program needs updating as well.

In the residential care industry, “substantial rehabilitation,” although distinguished from new construction, denotes a level of rehabilitation that brings a facility to near-new condition. While rehabilitation of such a level is appropriate and within the Section 232 Program’s existing definition of “Substantial Rehabilitation,” many facility improvement projects that do NOT rise to that level would nevertheless fit within the Section 232 definition of Substantial Rehabilitation.

## **II. Section 232 Substantial Rehabilitation Program Change**

HUD is narrowing the definition of Substantial Rehabilitation in the Section 232 Program definition in several respects.

First, we are eliminating the language providing that “substantially” replacing “two or more major building components” could itself suffice as “substantial rehabilitation.” The language has long been a source of confusion and uncertainty as, for example, all parties attempted to determine in any specific context what constituted a “major building component,” and what degree of rehabilitation thereof was “substantial.” Moreover, even if such language were applied very narrowly, the result could still be a “substantial rehabilitation” mortgage insurance transaction that leaves the facility not “substantially rehabilitated” by the industry conception of that term.

Secondly, we are addressing the “repairs, replacements and improvements” definitional element. As presently worded, the element states that items can be so minimal as to cumulate to only 15% of the property’s as-completed value, and yet the 232 Substantial Rehabilitation Program could still apply. Yet experience shows that physical work of that minimal level does *not* necessarily result in a substantially rehabilitated facility; either the facility was not truly in need of substantial rehabilitation or, although substantial rehabilitation was needed, the amount expended did not effectuate such a level of rehabilitation.

Accordingly, the definition of Substantial Rehabilitation appearing in Section II – Production, Chapter 2, Section 2.6.B, of the Section 232 Handbook is hereby amended to read:

A project qualifies as a substantial rehabilitation project when:

The hard costs of repairs, replacements, and improvements (not including major movable equipment) exceed 25% of the project’s value after completion of all repairs, replacements, and improvements. Additions are permitted in substantial rehabilitation projects, but the costs of the addition are not included in the eligibility test.

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