

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

4225.1

CIRCULAR

January 30, 1973

SUBJECT: Section 312, Processing

1. This Circular Transmits the Following:
HUD Handbook 4225.1, Section 312, Processing.
 2. Purpose:
This Handbook sets forth the policies, procedures, and requirements applicable to HUD-FHA's role in processing Section 312 direct loans for rehabilitation in urban renewal areas.
 3. Applicability:
This Handbook contains rules, regulations and policy matters in effect as of December 31, 1972.
 4. Cancellations:
The following issuances are cancelled:

Handbook - FHA 4410.1 - Section 312 Processing
dated August 8, 1968

FHA 4410.1 - Section 312 Processing
Change 1 dated May 5, 1969

Circular - FHA 7210.1 - FHA's Role in Processing Section 312
Direct Loans for Rehabilitation
dated February 2, 1968
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SECTION 312

REHABILITATION LOANS

JANUARY 1973

HUD STAFF

A HUD HANDBOOK

HOUSING PRODUCTION AND MORTGAGE CREDIT-FEDERAL HOUSING ADMINISTRATION

U. S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, D. C. 20410

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FOREWORD

This Handbook sets forth the policies, procedures, and requirements applicable to HUD-FHA's role in processing Section 312 direct loans for rehabilitation in urban renewal areas, Section 117 concentrated code enforcement areas, certified areas and areas covered by a FAIR plan (Fair Access to Insurance Requirements.) The instructions in this Handbook cover Section 312 rehabilitation loans on residential properties and mixed-use loans on properties involving both residential and nonresidential uses.

Procedures relating to loan applications on properties that are solely nonresidential in character are not specifically covered in this Handbook as such. However, in processing the few nonresidential cases submitted by LPAs, the Field Office will employ the same requirements applicable to the nonresidential portion of a loan for \$3,500 or more on a mixed-use property of 5 or more dwelling units as outlined herein.

References:

- (1) CD 7399.1 - Field Management Procedures Handbook
Chapter 6, Section 6
- (2) CD 7375.1 - Rehabilitation Financing Handbook
- (3) CD 7390.1 - Certified Area Program Handbook
- (4) CD 7377.1 - FAIR Handbook
- (5) HM 4310.20 - Acquisition of Properties Pledged as
Security for Section 312 Rehabilitation Loans

Cancellations: This Handbook cancels Handbook FHA 4410.1, 4410.1 Change 1 and Circular FHA 7210.1.

CHAPTER 1. SECTION 312 PROCESSING

- 1-1. LEGISLATIVE AUTHORITY. Section 312 of the Housing Act of 1964 as amended by the Housing and Urban Development Act of 1965 authorizes the Secretary of HUD to make direct loans at an interest rate that may not exceed 3 percent to owners or tenants of residential or business property in urban renewal and code enforcement areas to finance the rehabilitation required to make the property conform to code requirements in a code enforcement project or to carry out the requirements and objectives of the urban renewal plan in an urban renewal project. The Section also authorizes loans to residential owner-occupants in certified areas to conform their property to local code requirements. In addition it also authorizes loans to owners and tenants to correct physical hazards in properties, not located in federally assisted areas, to make these properties insurable under a HUD-FHA approved statewide FAIR plan.
- 1-2. DEFINITIONS.
- a. Fair Access to Insurance Requirements: (FAIR plan)
 - b. Public Body means: The Local Public Agency (LPA) administering the federally assisted urban renewal project and the municipality administering the Section 117 concentrated code enforcement project or certified areas.
 - c. Community Development Representative (Rehabilitation Loans and Grants) hereinafter referred to as the CDR-(RLG): means Member of our Office Staff responsible for handling Section 312 Loans.
- 1-3. ADMINISTRATIVE RESPONSIBILITY.
- a. Responsibility for administering the Section 312 loan program rests with the Assistant Secretary for Community Development and with the HUD Field Offices. Field Offices will work closely with Public Bodies in assisting property owners to make application for rehabilitation loans.

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- b. In the case of Section 312 loan applications in FAIR areas, Field Offices will be responsible for carrying out many of

the usual functions of the Public Body. See Reference (1) of the Foreword. Therefore, for purposes of this publication where LPA action is indicated and in cases involving FAIR loans, such action will in fact be performed by the CDR-(RLG), or the applicant as required by Reference (1) of the Foreword.

- c. Field Offices will make "as is" appraisals on all types of properties including one-to-four dwelling units on request from the LPA. The Field Office will review the applications for direct loans on properties involving units, and notify the CDR-(RLG) of its recommendation. In addition, Field Offices will make compliance inspections on properties containing 5 or more dwelling units after rehabilitation when the loan is for \$3,500 or more.

1-4. FORMS.

- a. HUD-FHA will use FHA Forms when making "as is" appraisals for the LPA. LPAs' requests for "as is" appraisals must be submitted to HUD-FHA on HUD Form 6242 and accompanied by FHA Form 2800 for all residential properties containing one-to-four dwelling units. HUD Form 6242 for all other appraisal requests must be accompanied by FHA Form 2013-R. The CDR-(RLG) will modify these forms accordingly upon request for a FAIR loan.
- b. When FHA Form 2013-R is appropriate, it will be necessary to complete only portions of Part I of the Form as follows: complete the applicable portions of Sections "A," "B," and all of "E." Complete the "Before" columns of Sections "H," and "I," and "J" and attach a legal description of the property as required in Section "W" of the Form. The remaining portions of the entire Form need not be completed. The word "Sponsors" as used in Section "B" is construed to mean "Mortgagors." In all instances a copy of the completed appraisal report Forms will be forwarded to the LPA for inclusion in the prepackaged application to be submitted to the CDR-(RLG) for review and transmitted to the Technical Services Branch, or to the Chief Underwriter, as appropriate.

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- 1-5. AUTHORIZATION AND LOAN AMOUNT LIMITATIONS. The Secretary is authorized to make Section 312 loans for rehabilitation provided the borrower is unable to secure the necessary funds from other sources on comparable terms and conditions and the loan is an acceptable risk. The interest rate on any such loan may not exceed 3 percent and the maturity may not exceed 20 years or

three-fourths of the remaining economic life of the structure after its rehabilitation, whichever is less. The amount of loan for eligible properties is contained in Reference (2) of the Foreword. The Reference covers in detail all of the above limits which must be used as the basis for reviews.

- 1-6. ELIGIBILITY FOR SECTION 312 LOANS. In order to be eligible for a Section 312 loan the applicant must be an owner of property located in an urban renewal area, a Section 117 concentrated code enforcement area, a certified area or an area covered by a state-wide FAIR plan. For additional eligibility requirements refer to the appropriate program handbook:
- a. Urban renewal and Section 117 concentrated code enforcement area. See Reference (2) of the Foreword.
 - b. Certified areas. See Reference (3) of the Foreword.
 - c. FAIR areas. See Reference (4) of the Foreword. For Rehabilitation financing in FAIR areas, see References (1) and (2).
- 1-7. HUD-FHA ASSISTANCE IN THE DEVELOPMENT OF LOAN APPLICATIONS.
- a. Where the loan is \$3,500 or more and the property contains five or more dwelling units, the Field Office in addition to making an appraisal of the property may, upon request from the LPA, and expeditiously as possible:
 - (1) Accompany an LPA representative to the property and collaborate in preparing work write-up or review on the site the work write-up previously prepared by the LPA;
 - (2) Review the cost of the work to be done as estimated by the LPA and reach an agreement with the LPA as to reasonableness:
 - (3) Review the contract proposal which has been secured from an acceptable contractor.

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- b. When considered necessary, and especially during a reasonable training period, the LPA may request preliminary review of a completed application and advice from appropriate Field Office personnel prior to forwarding the completed application to the CDR-(RLG). After a reasonable training period such requests will normally be limited to the more difficult or

questionable cases.

1-8. SECTION 312 "AS IS" APPRAISAL PROCEDURES.

a. "As is" value for Section 312 purposes is defined as the highest price which a property will bring if exposed for sale in the open market allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used. The value sought presupposes all cash to the seller with the purchaser financing the transaction by the most advantageous means and terms generally available throughout the entire city. The value must also assume that all properties in the neighborhood, except the subject property, have been upgraded to the level established by the urban renewal plan or the Section 117 code enforcement program.

(1) Appraisals in certified areas will assume that all properties in the area have been upgraded to the level of local code requirements.

(2) Appraisals in FAIR areas will be for "Market Value" and assume all of the properties in the neighborhood will be made insurable.

b. One-to-eleven dwelling unit residential properties will be appraised using the "as is" appraisal procedures for home mortgages under Section 220.

The appropriate Underwriting Report Form will be completed utilizing the three tests of value as applicable. Greatest reliance and emphasis will be placed on the market comparison technique. Closing costs will not be included for Section 312 purposes.

(1-8) c. Properties containing two or more dwelling units may be appraised using multifamily appraisal procedures and Rental Housing Project Income Analysis and Appraisal, FHA Form 2264. The comparison test of value will be made using gross rent multipliers and sales prices per unit as bases for comparison. This test will ordinarily carry the greatest weight in estimating "as is" value. The estimate of replacement cost will not be made except on relatively new properties where such estimate has relevance. The capitalization approach will be utilized in properties which are enjoying a measurable income. Gross income, expenses and taxes will be determined

based on use of the property in its "as is" condition. The estimate of economic life for "as is" capitalization purposes will be based on the present condition of the building. Net income will be capitalized into value utilizing an overall capitalization rate or band of investment "built up" rate as appropriate. Income resulting from illegal uses and code violations will not be considered even though the code has not been enforced.

- d. When the usual tests of value cannot be used because of lack of sufficient sales data or measurable net income, the "as is" value may be estimated as a residual of the fair market value after rehabilitation. The fair market value after rehabilitation is found by market comparison and/or capitalization techniques. The value after rehabilitation should reflect the beneficial effects of the urban renewal plan or the Section 117 Code Enforcement Program, and should assume a level of rehabilitation sufficient to meet the rehabilitation standards of the urban renewal plan or code enforcement program, and the legal use permitted by codes and zoning. The beneficial effects of the legal use permitted in certified areas and FAIR areas should also be given consideration in determining fair market value after rehabilitation.
- e. From the after rehabilitated value will be subtracted the estimate of necessary rehabilitation costs including applicable financing expense incident to the rehabilitation to arrive at "as is" value before rehabilitation. The debt service residual approach to "as is" value will not be used in Section 312 cases.

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- f. When neither sufficient market data nor net income information is available to establish fair market value and HUD-FHA decides that the residual technique is appropriate, Field Offices will request the LPA to furnish it the estimated cost of rehabilitation for use in establishing "as is" value on the residual basis.
- g. The Assistant Director, Technical Services or the Chief Underwriter (ADTS/CU) is authorized to increase the "as is" value by up to 5 percent for any specific case when in his opinion the appraisal factors in the case merit such an increase.

- a. Section 312 requires in each case an estimate of economic life after rehabilitation. In making the estimate of economic life after rehabilitation, it must be recognized that rehabilitation will tend to enhance the attractiveness of a property for the prospective occupants which compose its market. Of primary concern are the specific neighborhood improvements to which the locality is committed in the approved urban renewal plan and also the improvements to privately owned real estate which will have to be made as a result of the enforcement of local codes and the urban renewal plan. The processor is to assume the completion of those improvements in accordance with commitments made by the community and thus is not required to base his conclusion upon conjecture. The urban renewal plan will permit construction of new properties and the rehabilitation of old properties with 40-year mortgages. There should be little problem therefore in finding economic life estimates to justify a 20-year mortgage on the property after rehabilitation even though the specific extent of the rehabilitation is not available at the time of the "as is" appraisal.
- b. The ADTS/CU may increase the estimate of economic life whenever the facts or needs of a specific case so indicate. He should be guided by consideration that HUD-FHA approval of urban renewal and concentrated code enforcement programs are predicated on program activities that arrest neighborhood decline and substantially extend area viability. These factors should be easily sufficient to provide estimates of reviewing economic life capable of supporting loan terms of 20 years.

1-10. APPLICATIONS FOR SECTION 312 LOANS.

- a. An application which has been determined by the LPA to be eligible for a Section 312 loan will be referred by the LPA to the CDR-(RLG). Applications involving loan amounts of \$3,500 or more on residential mixed-use properties containing five or more dwelling units will, after review by the CDR-(RLG), be referred to the ADTS/CU for review and recommendations. Review will be conducted in accordance with procedures used in processing Section 220(h) and 220 loan applications. This involves review of the LPA work write-up, review of estimated rehabilitation costs for reasonableness, determination of the acceptability of the proposal for work to be done, and review of the paying capacity of the applicant. ADTS/CU will also review the application to determine that the amount

of the loan does not exceed the amount which would be permitted under the statutory requirements of Section 220(h). (See limits in Reference (2) of the Foreword.)

- b. After the review is completed, the application will be returned to the CDR-(RLG) with a note indicating approval or rejection. If the approval amount differs from the requested amount or if it is recommended that the application be rejected, the reason for the recommendation must be given.

1-11. APPLICATIONS FOR ONE-TO-FOUR DWELLING UNIT PROPERTIES.

- a. By making an appraisal, the Field Office will assist the LPA in processing Section 312 rehabilitation loan applications for \$3,500 or more on one-to-four dwelling unit residential and mixed-use properties, under either home mortgage or multifamily procedures as applicable. Further review and compliance inspections on one-to-four dwelling unit properties will not be made by the Field Office.
- b. All requests for FAIR appraisals, regardless of the amount of loan or number of dwelling units, will be processed by the Field Office.

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1-12. APPLICATIONS FOR \$3,500 OR MORE ON FIVE OR MORE DWELLING UNIT PROPERTIES.

- a. Applications for loans on properties with five or more dwelling units may be processed under the home mortgage provisions or the multifamily provisions of Section 220(h).
- b. Applications for loans on properties with 12 or more dwelling units may only be processed under the multifamily provisions of Section 220(h). In addition, the Field Office will make compliance inspections on all properties reviewed by the Technical Service Branch.
- c. Applications submitted for processing under Section 220(d)(3)(A), home mortgage provisions will be processed by the LPA in accordance with home mortgage procedures under Section 220 and applications submitted under Section 220(d)(3)(B), multifamily procedures.

1-13. MIXED-USE PROPERTIES. A mixed-use loan is a Section 312 loan made to the owner of a mixed-use property when the necessary rehabilitation applies to both the residential and nonresidential

portions of the property. (Mixed-use loans as they relate to the certified areas are not covered in this paragraph due to their ineligibility in these areas.)

- a. The Field Office will assist the LPA by making appraisals on all mixed-use loans of \$3,500 or more. The ADTS/CU, upon referral by the CDR-(RLG), will review applications on all mixed-use loans of \$3,500 or more (that involve more than 5 dwelling units in the residential portion of the property) by using procedures similar to those already outlined, except for the variation set forth below:

- (1) Ratio of Commercial to Residential. The outstanding instructions in HUD-FHA regulations, manuals, letters etc., governing the percentage or ratio of commercial area to residential area in Section 220(h) or 220 loans do not apply to Section 312 mixed-use loans. The amount of commercial in relation to the amount of residential is determined by the intended and practical use of the property.

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- (1-13) (2) Limitations on Mixed-Use Loan Amount. The maximum loan amounts for mixed-use properties are established separately for the residential and commercial portions. For this purpose, allocations of existing debt and rehabilitation cost to the residential and commercial portions are made by the LPA in accordance with instructions contained in Reference (2) of the Foreword.
 - (a) These allocations are made a part of the application for a mixed-use loan and must be presented in the format given in Reference (2) of the Foreword. The sum of the residential loan amount and the commercial loan amount represents the maximum single loan which may be placed on the property; and the combined net income from both the residential and commercial use must be sufficient to support all indebtedness against the entire property.
 - (b) The maximum amount that may be included in a mixed-use loan is explained in Reference (2) of the Foreword, which must be used as a basis for reviewing mixed-use applications.
 - (3) Allocations of "As Is" Value, Existing Debt, and Rehabilitation Costs. The "as is" appraisal made by

HUD-FHA will be used by the LPA in calculating the portions of "as is" value allocable to the residential portions of the property. The LPA also will allocate existing debt and rehabilitation costs to the residential and nonresidential uses in accordance with instructions in Reference (2) of the Foreword.

- (4) "As Is" Value and Value After Rehabilitation.
- (a) As in the case of properties involving residential rehabilitation only, the LPA will request from the Field Office and estimate of the "as is" value of the entire property prior to the preparation of the loan applications.
 - (b) An estimate of the after rehabilitation value attributable to the commercial portion will be requested at the same time. The after rehabilitation value is to represent the fair market value to an investor and must reflect the beneficial effects of the urban renewal plan, the Section 117 code enforcement program, or the benefits attributable to Fair activity areas.

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- (1-13)
- 1 First, the after rehabilitation value of the entire property will be estimated following current procedures for income producing properties (without any cost estimates). For this purpose, assume a level of rehabilitation sufficient to meet the rehabilitation standard, of the urban renewal plan or to meet the code requirements in a code enforcement program area, or to make the structure insurable under the state-wide FAIR plan.
 - 2 Existing leases should be disregarded in estimating income from the property. The value of the commercial portion of the property for LPA's use will be determined by multiplying the property value by the ratio of commercial rent to the total rent of the entire property.
- (5) Review of Loan Application. In the review of the completed mixed-use loan applications for the LPA, the Field Office must bear in mind that the criteria for acceptance are the reasonableness of the estimates and conclusions. The income and expense estimates need not

agree with the Field Office estimates used in the after rehabilitation appraisal provided they are reasonable. In addition, the after rehabilitation value estimates will not be changed unless requested by LPA even though the level of rehabilitation proposed differs materially from that assumed in the appraisal.

- (6) Debt Service Considerations. Although for loan limits in a mixed-use loan the residential and commercial parts of the property are treated separately, the mixed-use property shall be treated as a single entity for credit purposes.

The income generated by the entire property as rehabilitated must be sufficient to meet all operations and management expenses, taxes, and insurance; plus debt service requirements for existing debt secured by the property and the proposed rehabilitation loan.

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- 1-14. HUD-FHA INSPECTIONS ON RESIDENTIAL AND MIXED-USE PROPERTIES. On Section 312 loans of \$3,500 or more on residential and mixed-use properties with five or more dwelling units the Field Office will, after receipt of a copy of the executed contract and related documents, make compliance inspections as it deems necessary and will make inspections for progress payments and final inspections when notified by the LPA that the work is ready to be inspected. Field Offices will furnish the LPA with inspection reports as to the acceptability of the work completed. The Field Offices will also report any unacceptable work or other conditions likely to be of concern to the LPA. Field Office reports will be signed by the ADTS/CU or his designee. The clear final inspection report shall be titled "Final Inspections Report" and shall state that "All of the work has been completed in accordance with the contract and related documents." HUD-FHA's dealings regarding compliance matters will be with the LPA and not with the borrower or the contractor. The LPA may request inspections by telephone or in writing.
- 1-15. FEE SCHEDULE. Under a reimbursable agreement between the Assistant Secretary for Community Development and the Assistant Secretary for Housing Production and Mortgage Credit for all applications on which the Form HUD 6242 is dated May 1, 1969, or later HPMC will be reimbursed for services on the following basis:
- a. For owner-occupied and investor-owned residential property,

one-to-four dwelling units, \$35 total fee for appraisal. The fee is earned when the appraisal is made.

- b. For investor-owned residential property containing five or more dwelling units, mixed-use property and nonresidential property.
 - (1) For appraisal, the higher of \$65 or \$3 per \$1,000 of the estimated loan amount. The fee is earned when the appraisal is made.
 - (2) For processing and inspection.
 - (a) No additional charge on loans of \$8,125 or less.

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- (b) For loans in excess of \$8,125, \$8 per \$1,000 of the estimated loan amount less the appraisal fee determined in accordance with b.(1) above. The entire fee based on \$8 per \$1,000 or \$65, whichever is larger, is earned when the loan application is accepted by ADTS/CU for processing.

- 1-16. BILLING FOR FEES. Fees are not to be remitted to Field Offices. The Office of the Secretary will be billed monthly by the Office of the Comptroller. To enable the billing and paying offices to accomplish this reimbursement, HUD Field Offices must process pages 2 and 3 of Form HUD 6242 as follows:
- a. Page 3, Form HUD 6242. Promptly upon receipt of the request for "as is" appraisal, page 3 or the request is to be receipt-signed, dated, and mailed as preaddressed in Panel H.
 - b. Page 2, Form HUD 6242.
 - (1) Owner-Occupied and investor-owned one-to-four family property when the appraisal has been completed, in Panel H insert the entry "Fee for appraisal, \$35."
 - (2) Investor-owned and mixed-use properties containing five or more dwelling units and all nonresidential properties. First make a photo copy of page 2. Determine the amount of the fee for appraisal as prescribed in paragraph 1-15.b.(1) above and make the entry "Fee for appraisal, \$ (amount)" in Panel H on the printed page 2 and forward for billing. When the loan application is accepted for processing, determine the amount of fee for processing

and inspection, if any, as prescribed in paragraph 1-15.b.(2) above and make the entry "Fee for processing and inspections, \$(amount)" and forward for billing. The photo copy will not be used unless an additional fee for processing and inspection is applicable.

- (3) Mailing of Page 2, HUD Form 6242. To insure prompt billing to the Office of the Secretary by the Office of the Comptroller, it will be the responsibility of the Chief Appraiser in each Area and Field Office to forward by transmittal memorandum by the close of business and the fifth working day of each month, all pages 2 of the Form HUD 6242 for all appraisals completed and for all

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loan applications accepted for processing during the preceding month. The memorandum should be addressed to the Office of the Comptroller, Accounting Division, Attention: Accounting Branch, Washington, D.C., 20410 and should indicate (1) the number of printed pages 2 covering appraisal fees and (2) the number of photo copy pages 2 covering processing and inspection fees.

- 1-17. EXPENSE REPORTING. To conform with budget and accounting requirements the reporting of time and travel expenses related to Section 312 appraisals and processing and inspection will be handled similar to miscellaneous types of reimbursable activities as provided for by current time and cost reporting instructions.
- 1-18. ACQUISITION OF PROPERTIES PLEDGED AS SECURITY FOR SECTION 312 REHABILITATION LOAN. HUD-FHA Field Office personnel will be involved, to some extent, with the acquisition of Section 312 properties pledged as security for loans. Reference (5) of the Foreword contains instructions regarding this type of activity and should be referred to when dealing with acquisitions.

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