TRANSMITTAL
NOTICE
December 11, 1972

1. This Notice Transmits the Following:
   HUD Handbook 4260.1, Section 223(a), (e), and (d),
   Miscellaneous Type Home Mortgage Insurance.

2. Explanation of Materials Transmitted:
   This Handbook provide policy and processing procedures for HUD
   staff and others interested in mortgage insurance under the
   Section 223 programs.

3. Applicability:
   This Handbook contains rules, regulations and policy matters in
   effect as of September 30, 1972. All issuances released
   subsequent to September 30, 1972, take precedence over the
   contents of this Handbook where applicable.

4. Cancellations:
   The following issuances are cancelled:

   FHA Manual - Volume VI, Book 2, Part B, Preapplication
   Appendix A-1 and A-2

   Volume VII, Book 1 and 2
   Paragraphs 70764.1 thru 70764.9
   Paragraphs 71428 thru 71429.4
   Paragraphs 71433 thru 71433.2
   Paragraph 71603.3
   Paragraphs 71982.10 thru 71982.13
   Paragraphs 72458 thru 72458.7
   Paragraphs 72726 thru 72726.1
   Paragraphs 72925 thru 72925.16
   Paragraphs 73033 thru 73033.5
   Paragraphs 73087.10 thru 73087.20
   Paragraphs 73079 thru 73079.2
   Paragraphs 73087.50 thru 73087.52
   Paragraphs 73089.10 thru 73089.12
   Paragraphs 73089.15 thru 73089.17

FOREWORD

Section 223 is to assist governmental agencies in the sale of
existing properties through the use of HUD-FHA mortgage insurance.
This authority is set forth under Section 223(a). General
information, and processing instructions in connection therewith are
contained in this Handbook.

The Handbook also contains instructions and general information for
Section 223(e) which authorizes mortgage insurance in older
declining urban areas where "economic soundness" and "economic life"
requirements are waived under certain risk conditions and Section
223(d) two year operating losses.
References:

(1) (4425.1)* - Application Through Firm Commitment for Project Mortgage Insurance

(2) (4410.1)* - Project Fiscal Procedures

(3) HPMC-FHA 4200.15 (4480.1)* - Multifamily Reports and Forms Catalog

(4) HPMC-FHA 4010.9 (4110.1)* - Fiscal and ADP Handbook

*The information in parentheses indicates the location of the referenced material in the new classification system.


11/72

U. S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
HOUSING PRODUCTION AND MORTGAGE CREDIT - FHA

TRANSMITTAL No. 1

August 29, 1975

1. This Transmittal Transmits:
Revision to HUD Handbook 4260.1, "Miscellaneous Type Home Mortgage Insurance Section 223(a), (e), and (d).

2. Explanation of Material Transmitted:
Chapter 3, paragraph 3-7.c. is changed to delete the requirement that Field Offices submit to the Office of Field Support a listing of home mortgage commitments issued each week pursuant to Section 223(e).

3. Filing Instructions:
Remove Insert

Pages 3-3 and 3-4, dated 11/72 Pages 3-3 and 3-4, dated 8/75

Assistant Secretary for Housing Production and Mortgage Credit --
Federal Housing Commissioner
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CHAPTER 1. ADMINISTRATIVE INSTRUCTIONS

1-1. TYPES OF INSURANCE AND REFINANCING. Section 223 of the National Housing Act authorizes the Assistant Secretary-FHA Commissioner:

a. Section 223 of the Act:
   
   (1) To insure miscellaneous type mortgages (223a).
   
   (2) To refinance existing mortgages (223a and 223b).
   
   (3) To insure mortgages assigned to him or executed in connection with a sale by him (223c).
   
   (4) To insure a loan to cover the excess of expenses over project gross income incurred during the first two years following the date of completion of the project, for such amounts, and upon such terms and conditions as he may prescribe (223d).
   
   (5) To insure mortgages on properties located in older declining urban areas (223e).

b. Legal Authority. Section 233 of the National Housing Act (Public Law 73-479) as added by the Housing and Urban Development Act of 1968 (Public Law 90-448), 12 U.S.C. 1715x.

1-2. AUTHORITY REGARDING COMMISSIONER-HELD PROPERTY. Authority is given to the Assistant Secretary-FHA Commissioner to insure, pursuant to Section 233, any mortgage assigned to him or executed in connection with the sale by him of any property acquired under any Section or Title of the Act without regard to any limitation upon eligibility contained in Title II of the Act.

1-3. SECTION 233(a) (1-6) OF ACT-RENTAL PROJECTS SOLD BY PUBLIC AGENCIES OR POLITICAL SUBDIVISIONS (UNDER SECTION 207).

a. Miscellaneous Type Mortgages. Miscellaneous type mortgages within the provisions of Section 223(e) of the Act include those executed in connection with the sale of property by the Government, the Secretary, Housing and Urban Development, Greenbelt Towns, the Department of Interior, Atomic Energy Commission, and others under prescribed conditions as set forth in the Act.

1-4. AUTHORITY UNDER REGULATIONS. As set forth in Section 207.31 of the Regulations, HUD-FHA is authorized by Section 223(a) (1) through (6) to insure, under Section 207 of the Act, mortgages for rental housing projects sold by federal, state or local public agencies, instrumentalities or political subdivisions.
Such mortgages shall be:

a. Executed in connection with the sale by the Government, or any agency or official thereof, of any housing acquired or constructed under Public Law 849, 76th Congress, as amended, or Public Laws 9, 73 or 353, 77th Congress, as amended, (including any property acquired, held, or constructed in connection with such housing or to serve the inhabitants thereof); or

b. Executed in connection with the sale by the Public Housing Administration, or by any Public Housing Agency with the approval of the said Administration, of any housing (including any property acquired, held, or constructed in connection with such housing or to serve the inhabitants thereof) owned or financially assisted pursuant to provisions of Public Law 671, 76th Congress; or

c. Executed in connection with the sale by the Government, or any agency or official thereof, of any of the so-called Greenbelt towns, or parts thereof, including projects, or parts thereof, known as Greenhills Ohio; Greenbelt Maryland; and Greendale Wisconsin; developed under the Emergency Relief Appropriation Act of 1935, or of any of the village properties or employee's housing under the jurisdiction of the Tennessee Valley Authority; or

d. Executed in connection with the sale by the Government, or any agency or official thereof, of any housing (including any property acquired, held, or constructed in connection therewith or to serve the inhabitants thereof) pursuant to the Atomic Energy Community Act of 1955, as amended: Provided, that such insurance shall be issued without regard to any preferences or properties except those prescribed by the Atomic Energy Community Act of 1955, as amended; or

e. Executed in connection with the sale by a state or municipality, or an agency, instrumentality, or political subdivision or either, of a project consisting of any permanent housing (including any property acquired, held, or constructed in connection therewith or to serve the inhabitants thereof), constructed by or on behalf of such state, municipality, agency, instrumentality, or political subdivision, for the occupancy of veterans of World War II, or Korean veterans, their families, and others; or

f. Executed in connection with the first resale within two years from the date of its acquisition from the Government, of any portion of a project or property of the character described in subparagraphs a., b., c., and d.
1-5. SECTION 223(a) (7) OF ACT-REFINANCING OF EXISTING INSURED MORTGAGES (UNDER 207).

a. Introduction. As set forth in Section 207.32 of the Regulations, HUD-FHA is authorized by Section 223(a) (7) of the National Housing Act, as amended, to refinance an existing HUD-FHA insured mortgage covering five or more rental units.

1-6. SCOPE AND NATURE OF SECTION 223(a) (7).

a. Section 223(a) (7) is a refinancing provision which might be of assistance in preventing acquisition. It is not to be construed as a rehabilitation provision.

b. If an upgrading plan is to be completed incident to refinancing, a project may be eligible for assistance. In some instances upgrading may be necessary to improve the competitive position of the project which may have become impaired through obsolescence of its design, functional plan or equipment. If the cost of upgrading will amount to one-fifth or more of the total mortgage amount, it is likely to be accepted directly under another HUD-FHA program as a rehabilitation case.

c. No upgradings, costs of capital improvements, or additions required incident to refinancing pursuant to Section 223(a) (7) can normally be included in advances to be insured.

1-7. REQUIREMENTS INCIDENT TO REFINANCING-MORTGAGE AMOUNT. The amount of the mortgage, accepted for insurance under Section 207 pursuant to Section 223(a) (7), may not exceed the lowest of the following limits:

a. The original principal amount of the existing insured mortgage.

b. The unpaid principal amount of the existing insured mortgage, to which may be added:

   (1) The outstanding indebtedness incurred in connection with capital improvements made to the property which are acceptable to the Assistant Secretary-FHA Commissioner.

   (2) The costs, as determined by the Assistant Secretary-FHA Commissioner, of capital improvements, upgrading or additions required to be made to the property, and
(3) Loan closing charges which may include financing expense not to exceed 1 1/2%, title and recording expense and legal and organization expense. No discount may be included in estimating the maximum mortgage amount.

c. 90% of the HUD-FHA estimate of the value of the project.

d. An amount which entails a debt service (including special assessments, if any, and ground rents, if leasehold) not in excess of 90% of the HUD-FHA estimate of net income.

1-8. REQUIREMENTS INCIDENT TO REFINANCING MORTGAGE TERM.
The term of the mortgage, accepted for insurance under Section 207 pursuant to Section 223(a) (7), may not exceed the unexpired term of the existing mortgage, except that in any case in which it is determined that the insurance of a mortgage for an additional term will inure to the benefit of the applicable insurance fund, taking into consideration the outstanding insurance liability under the existing mortgage and the remaining economic life of the property, such refinancing mortgage may have a term of not more than twelve (12) years in excess of the unexpired term of such existing insured mortgage.

1-9. REQUIREMENTS INCIDENT TO REFINANCING-AMORTIZATION.
Amortization of the mortgage, accepted for insurance under Section 207 pursuant to Section 223(a) (7), shall be in accordance with the Level Annuity Monthly Payment Plan since, as a matter of general policy, it is the objective of HUD-FHA that refinancing and upgrading of projects with the assistance of HUD-FHA mortgage insurance shall be accomplished without appreciable increase in rents.

1-10. REQUIREMENTS INCIDENT TO REFINANCING - RESERVE FOR REPLACEMENT ACCOUNT. A reserve for replacement account, in connection with the mortgage accepted for insurance under Section 207 pursuant to Section 223(a) (7), shall be established to cover the new insured mortgage amount. The commitment will require that the balance in the existing reserve account be applied to:

(1-10) a. The amount required to be escrowed for reserve items scheduled for delayed replacement, and

b. The cost of items being replaced incident to the refinancing. In the event there is any balance remaining in the account, it shall be released to the mortgagor at the time of initial/final endorsement.
CHAPTER 2. UNDERWRITING INSTRUCTIONS

2-1. COST PROCESSING. Projects submitted under this Section shall be processed and estimated in accordance with the Section of the Act under which they are submitted pursuant to Section 223.

a. When requested by the ADTS, MFC or ADSF/CU, the Cost Analyst shall prepare estimates for repairs, minor rehabilitation and/or for work that is to be escrowed.

2-2. ARCHITECTURAL PROCESSING - GENERAL. To assist governmental agencies in the sale of existing properties, HUD-FHA may insure mortgages under any Section or Title of the Housing Act pursuant to Section 233. In this connection HUD-FHA provides an expression of eligibility of such properties for mortgage insurance that may be used by the governmental agency in disposing of them, and to subsequently insure mortgages on the properties. Eligibility and acceptability may be predicated upon requirements for necessary repairs and improvements.

a. To be eligible the property shall:

(1) Comply with the eligibility criteria set forth in Section 203.43 of HUD-FHA Regulations.

(2) Contain not more than eight living units. (Properties having five or more living units may also be submitted as project mortgages pursuant to Section 233.) Under Section 222 pursuant to Section 223, properties may have not more than one living unit.

(3) Comply with the General Acceptability Criteria and the applicable objectives of the Minimum Property Standards.

(4) Have accommodations, appeal and cost of maintenance and operation comparable with competitive properties.

(5) Be suitable for type of use, ownership, occupancy and management proposed.

(6) Have complete utility services without dependence on other properties, except for such joint utilities as are protected by acceptable easements. As in all properties accepted by insurance, easements must be minimized and careful note must be made of any that are likely to present adverse effects.

b. Eligibility is ascertained by examination of the premises and any exhibits provided. Where any deficiency exists and correction is feasible appropriate requirements are made as conditions of acceptance.
c. Working drawings and specifications composed primarily of the original contract drawings will be provided by the governmental agency for processing purposes but will not be retained permanently by HUD-FHA. Supplementary drawings and specifications, in duplicate, shall be required when necessary to show any modifications and improvements. A general site or plot plan is required in duplicate and must show the boundaries of the utilities thereto, when a subdivision of the original project is proposed. These are retained by HUD-FHA together with supplementary drawings in the master binder and reference is made thereto in other binders for each case.

2-3. SINGLE FAMILY PROCESSING. Architectural processing will conform to the procedures for Section 203(b), existing construction, except that the processing will be performed in the following four stages when the sale of groups of properties requiring repairs and rehabilitation is involved. These stages are: Preliminary, Appraisal and Eligibility, Precommitment and Compliance.

a. Preliminary Stages.

(1) The objective of this stage is to determine, with a reasonable degree of certainty, the suitability and eligibility of the property for mortgage insurance and to establish the essential repairs and improvements as well as to recommend others which are beneficial and feasible. It is also necessary to approximate replacement cost in new condition as well as the cost of repairs, alterations and improvements, including the costs of recommended items.

(a) FHA Form 2800-3 will be used for this purpose.

(b) However, a commitment (FHA Form 2800-5) is not issued at this stage, since a formal application for mortgage insurance has not been submitted.

(2) Examination and use of forms as described will be necessary but not with the degree of thorough study anticipated in the later stage of processing. The exercise of judgment and perception should result in a conclusion wherein all major requirements essential for eligibility will be established and costs approximated on a realistic basis, so as to avoid the need for a major change of conclusion in subsequent processing stages.

(3) Architectural examination of the property is primarily to observe its physical characteristics and to ascertain features which may preclude acceptance, or
which will require excessive expenditures by the owner for maintenance, repair or operation.

(a) For example, materials which are not durable, or appropriate, or properly assembled; inefficient heating systems or those requiring frequent repair, adjustment or replacement; or structures which are poorly insulated could all involve excessive expense in management which should be recognized even if not evident to a degree justifying immediate correction for eligibility.

(b) Other factors such as unsatisfactory method of refuse collection and disposal, water supply and sewage disposal, and deteriorated bathroom floors or walls may be sources of excessive expense in operation.

(4) In order to provide an orderly record of the physical condition of the property and to facilitate its examination, HUD-FHA Form 2450-R, Report of Architectural Inspection, will be prepared. Circumstances will govern the decision as to whether a single FHA Form 2450-R will suffice, or whether it would be more desirable to use a separate form for each building. Also, during this examination a Description of Materials, FHA Form 2005, is prepared for each basic structure. This will provide a record of the existing construction and will also show, by means of amendments made in red pencil by the processor any new work or changes to be made.

(5) Requirements must be made for repairs and for replacements which are not needed and which are indispensable to make the buildings sound and safe with respect to sanitary and structural conditions, and to provide appropriate resistance to the elements.

(2-3) (a) If prudent management would indicate that the replacement of an item could be deferred a year or more by repairs, then repairs rather than immediate replacement are to be required.

(b) However, in no instance may the correction of a deficiency be deferred if it is in any way of major importance and likely to have an adverse effect on the purchaser's financial ability to continue ownership.

(6) Requirements to restore to the original state, or to an improved condition of freshness, must be limited to those which are absolutely indispensable to provide living accommodations and appearances necessary to
keep the present tenants or to attract tenants or prospective purchasers of the type anticipated in the market.

(a) It seldom, if ever, will be necessary to require that the dwelling structure or living unit be put in "equal-to-new" condition.

(b) The painting of a building to improve its appearance will not be required when paint is not needed to prevent deterioration.

(c) Replacement of wooden steps with concrete steps will not be required if the need for the immediate replacement is not apparent.

(d) Decorating will not be required unless necessary to hold the present occupant or to attract a new one.

(7) Improvements or repairs may appear desirable even though not essential for eligibility. These may increase livability and appeal, or reduce maintenance or operating expenses, all of which would serve to make ownership of the properties more attractive. Any such items should be included as "Recommendations."

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(2-3) (8) In some instances, it may be found that the condition of the property is such that the expenditures required to make it eligible for mortgage insurance would not be warranted, since the monies so expended would not increase the value of the property sufficiently to make the expenditures feasible. Close collaboration with the other Underwriting Division Sections and the (ADSF/CU) will be required in those instances where this problem is encountered, and early discussion with the governmental agency representatives will be in order.

(9) A careful review of FHA Form 2450-R shall be made by the Chief Architect to eliminate from the requirements to be imposed all nonessential items, as well as to satisfy himself that all essential requirements will be made, and if possible that these will be those determined upon during preliminary discussions. He will also review the 2450-R from the point of view of determining the effect of the requirements on the cost of operation and maintenance of the property.

(10) At the conclusion of the Preliminary Stage the Chief Architect prepares a memorandum to the ADSF/CU which is routed through the Valuation Section setting forth for each property:
(a) An opinion as to suitability and eligibility under the Section of the Act that applications are most likely to be submitted. This opinion will include:

1. Requirements for correction of deficiencies, if any, essential for eligibility.

2. The approximate replacement cost in new condition together with separate costs of the necessary repairs, replacements or improvements.

3. Recommendations, if any, for repairs, replacements or improvements (not essential but desirable) with the approximate cost of each and reason for recommendations.

4. General comments including any with respect to excessive operating costs.

(2-3) (b) An opinion of ineligibility and reasons.

(11) If at any stage of processing further modification, changes or repairs appear essential, they must be necessitated on the basis of the acceptability criteria set forth above. While it is desirable that all such matters be disclosed in the preliminary review, they must not be ignored if revealed in subsequent processing stages.

b. Appraisal Eligibility Stage.

(1) Processing in this stage is similar to the processing of an application to commitment. Each property in a development must receive individual consideration, but use shall be made of repeat case procedures to the extent feasible. Further review of data and conclusions of the Preliminary Stage is required. Also a recheck and additional information may be warranted on FHA Forms 2450-R and 2005, and with respect to other data and conclusions.

(2) A requirement shall be included in the HUD-FHA report prepared for the governmental agency requesting the appraisal that evidence satisfactory to the Assistant Secretary-FHA Commissioner, shall be submitted prior to the issuance of a commitment to show that the buildings and improvements, existing as well as new, will be acceptable to the agency having jurisdiction and that certification as may be required with respect to occupancy will be granted to the mortgagor.
(3) Recommendations made in the Preliminary Stage are set forth in a memorandum attached to the Underwriting Report. It shall contain the estimated cost of each item and the anticipated benefit and effect of each.

c. Pre-Commitment Stage. Architectural processing in this stage is required only if the application requests mortgage insurance on some other basis than the report transmitted to the governmental agency requesting the appraisal.

(1) If a variation is proposed, a revised Underwriting Report is prepared reflecting the acceptable differences. The exhibits and specific conditions are reviewed for adequacy.

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(2) During this stage an effort is made to see that the applicant is informed of the benefits to be derived from all items previously recommended but not adopted by the mortgagor in the application.

(3) All effective requirements pertaining to the property under consideration are stated and included in the related commitment.

d. Compliance Stage. Compliance inspections conform to effective Section 203 instructions for existing construction with proposed or required alterations, additions or repairs.

2-4. ARCHITECTURAL PROCESSING. Project Mortgages (Reserved).

2-5. VALUATION PROCESSING. Section 203 pursuant to Section 233 involves proposed sales of existing government-owned housing or the first resale thereof within two years after its acquisition from the government. Cases involving properties of not more than four living units shall be, and properties having five or more but not more than eleven living units may be processed under these instructions.

a. Valuation procedures relative to Section 233 vary in some respects from regular Section 203 processing. Processing of Section 233 projects will generally follow this sequence, with variations as necessary to conform to any special statute pertaining to a particular disposal program:

(1) Preliminary Stage

(a) Property Examination

(b) Delineation of Properties
2-6. STAGES OF PROCESSING.

a. Preliminary Analysis Stage. The Valuation Section will assemble the following appraisal data in addition to other necessary data relative to the subject proposal:

1. Outline of the public agency's proposed sales plan.
2. Data relative to maintenance and operation of public rights-of-way and utilities.
3. Tax and hazard insurance data.
5. Current operating statements.
6. Waivers of local authority covering any code or zoning violations or, in the absence of formal waivers, some reliable evidence of early availability of such waivers.
7. Proposed protective covenants which are enforceable against the property.
8. A reasonably accurate map delineating the boundaries of the entire property and indicating its net area. Where subdivision of the project is proposed, the property survey is to show the boundaries of the parcels, the location of existing structures, street rights-of-ways, and utility easements, if any.
9. Drawings of the project including site and utility plans, noted to disclose known deviations in the actual construction, or as-built drawings if they are available.

(a) Property Examination: Valuation and Architectural Section representatives will
jointly consider the physical condition of the property and the necessity, scope, and approximate cost of any proposed or required repairs, alterations or replacements necessary to put the security in sound and acceptable condition. The Valuation Section will study the neighborhood and assembled data and provide comments and conclusions in determining the general price and rent level. The current and future marketability, and the economic life of the structures will likewise be studied.

(2-6) (b) Delineation of Properties: The Valuation Section will offer advice in establishing the acceptability of properties which require delineation prior to appraisal and sale as separate real estate entities. Existing or proposed easements for service lines or access will be studied to determine their effect on the utility and marketability of the property. Proposed dedication of streets, walks, and other public areas or easements, the assumption by a public body of responsibility for maintenance of such dedicated areas, and the acceptability of the proposed disposition of utility systems shall be considered carefully.

(c) Tentative Estimates of Value: The Valuation Section will prepare tentative estimates of value for use in final pre-application conferences. Sample appraisals on carefully selected typical sales units will be made.

b. Appraisal and Eligibility Stage. FHA Forms 2800-3 and 2017A will be used in processing as per current instructions for Section 203 processing. Since these properties may be in different sales price and rental range from that ordinarily considered in HUD-FHA analyses, data available in office files on competitive properties may be limited. Therefore the collection of applicable and relevant market data in the price range under consideration will be of prime importance. Likewise, the analysis of such comparative data should take into consideration the fact that properties in these price and rental categories may be appropriately equipped on a level less exacting than would normally be required in new Section 203 construction.

c. Pre-Commitment and Compliance Stage. Section 203 processing instructions will be followed.

d. Valuation Processing of Multifamily Projects Under
Sections 207, 213, 221, 231, 232, and 233 Pursuant to Section 233.

(1) To provide additional instructions for Valuation processing of applications involving the proposed value of existing government-owned housing or the first resale thereof within two years after its acquisition from the government. In addition instructions are provided for processing multifamily applications for properties located in older declining areas which though otherwise would not be acceptable due to location.

(2-6) Valuation procedures relative to these cases differ in some respects from the procedures and concepts applicable to other current HUD-FHA operations. These differences from basic instructions for valuation procedures are described below.

(3) Cases involving properties of five or more living units, shall be processed in accordance with the basic Section 207 instructions except as described below.

(4) Capitalization Approach. In the valuation of these existing rental income properties, the estimate of replacement cost may be of little worth. The proper approach will be that of capitalization of net income, supported in all instances by market comparisons. Should no recent transactions in similar properties be discovered, comparison shall be made with the properties most closely competitive.

(5) Estimate of Income. HUD-FHA will be supplied with a schedule of rents now in effect. Such rentals may or may not be the maximum available in the current market. Therefore, they should be carefully compared with rental data in the data bank.

(a) If existing rentals are below the fair market by reason of rent controls or otherwise, consideration must be given the time required for, and the possible tenant turnover occasioned by, a program of adjusting rents upward which would probably be instituted by a purchaser.

(b) In those instances where rents are still controlled, an estimate must be made of the probable time during which such controls
will remain in effect and the future income stream calculated accordingly.

(6) Limitation Upon Net Income. Maximum rent limitations are not imposed by the Assistant Secretary-FHA Commissioner in cases involving disposition of projects by public agencies that are eligible for processing pursuant to Section 223.

(7) Vacancy and Collection Loss Estimates. Because of the strong demand for housing in some areas, many of the properties may be fully occupied at the time of appraisal. Evidence of continued strong demand may justify a prediction that there will be relatively small vacancy and collection losses for a definite period in the immediate future. However, it will be necessary to adjust this estimate to reflect typical conditions over a long period of time.

(8) Operating Expense Estimates. The statement of operating expense to be furnished by the public agency will not be entirely applicable to the expense of operation under private ownership only as a guide and should adjust his estimates to agree with the data in the data bank.

(9) Estimate of Taxes. While in general, the real estate holdings of the government are not taxable, the properties held by the Public Housing Agency are subject to payment in lieu of taxes. The amounts were accepted by agreement between the local agency and the taxing agencies. They were calculated on the basis of the assessment methods, assessed values and tax rates prevailing in the community, except that in some cases it will be found that some services usually supplied by the taxing jurisdictions were omitted and the rates were adjusted accordingly. The assessed value and the resulting obligation are not carried on the tax rolls of the taxing agencies.

(a) The Valuator must make necessary investigations to determine whether the assessed values and the resultant payments in lieu of taxes under public ownership would represent a fair market estimate of taxes if the property were sold to a private owner. The figure thus determined will be used by the Valuator in processing.
(b) In the case of state, municipal, or other ownership, the Valuator may or may not have a parallel situation. In any event, he must estimate the probable annual taxes based on private ownership.

(2-6) (10) Hazard Insurance. The public agency may carry its own hazard insurance risk. Thus, factual information concerning insurable amounts and rates may not be available from insurance experience with regard to the properties. The types and amounts of hazard insurance and the terms of the policies are to be those typically used in the area by owners of properties of the kinds under appraisal.

(11) Estimate of Economic Life. In estimating economic life, consideration will be given the physical condition of structures, together with all other factors bearing upon their continued acceptance in the sales or rental market in the competitive price bracket in which they fall.

(a) It must be borne in mind that the type of construction typically found in these projects does not compare favorably with that encountered by the Field Offices in the production of new units. However, if they are in acceptable physical condition and are properly maintained, they may provide good housing accommodations in their price range for a fairly long term.

(12) Major Repairs, Maintenance and Replacements. It can be expected that these projects have been maintained in good livable condition and therefore, insofar as possible, will be sold on an "as is" basis, with repairs, maintenance and replacements as provided in current project budgets being continued to the time of sale. Deviation from this policy will be considered by HUD-FHA and perhaps other agencies in the event there is a substantial amount of such items which have been deferred, or if the completion of such items or alteration is required by the local governing body.

(a) HUD-FHA's interest will be in assuring itself that the structures proposed for insurance will have a remaining economic life sufficiently long, and that they may be maintained in satisfactory condition at
reasonable costs over the period of remaining economic life, to appeal in the current market and to have continued marketability during the term of the proposed mortgage.

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(b) Therefore, requirements must be made for any major repairs and replacements which are now needed to make the buildings structurally sound and livable and to assure continued structural soundness, resistance to the elements and safety to the occupants. The test will be whether a prudent management would dictate immediate repair or replacement, or whether an item should be deferred, say, one or more years.

(c) The valuation process will recognize the effective age of the structures and equipment.

(13) Replacement Reserve. Reserves for Replacement will be computed utilizing the factor shown on the FHA Form 2264. The computation will be based on the cost of "Total Structures" provided by the cost analyst. Major items requiring replacement within two years will be shown separately as an additional cash requirement to the reserve fund.

(14) Protective Covenants. The ADSF/CU shall require that suitable covenants be prepared and imposed when determined to be necessary.

2-7. MORTGAGE CREDIT PROCESSING - SINGLE FAMILY.

a. Applications involving mortgages of the types described in Section 203.43(b) (1), (2), (3), (4), (5), (6), and (7) of the HUD-FHA Regulations executed in connection with properties containing not more than seven living-units may be processed under this Section 203.

b. Maximum Insurable Mortgage. The statutory, regulatory, and mortgage credit limitations under Section 203(b) are applicable with the following exceptions:

(1) When the application involves property having more than four living units the dollar limitations for a four-family unit will apply.

(2) Applications involving mortgages under Section 203.43(b)(5) may not exceed 90% of the HUD-FHA of the property.
(3) A mortgage to refinance an existing mortgage insured under the Act (provided for under Section 203.43(b) (6), and (7) may not exceed:

(a) The amount of the unpaid principal balance of the existing mortgage plus the cost of any required or proposed repairs, improvements or additions to the property, and loan closing charges, or

(b) The original principal amount of the existing mortgage. (The term may not exceed the unexpired term of the mortgage being refinanced).

c. Applications involving mortgages of the types described in Section 203.43(b) (1), (2), (3), (4), (5), and (6) (incorporated in Part 222 reference of the HUD-FHA Regulations) executed in connection with single family dwellings purchased by qualified servicemen may be in accordance with outstanding instructions for mortgage credit analysis and procedure under Section 222.

2-8. MORTGAGE CREDIT PROCESSING OF MULTIFAMILY HOUSING PURSUANT TO SECTION 223.

a. Miscellaneous Type Mortgages. Applications involving mortgages of the type defined in Section 207.31 of HUD-FHA Regulations shall be processed in accordance with the instructions for Mortgage Credit Analysis under Section 207-Multifamily Rental Housing, except as modified herein.

(1) The mortgage must cover 5 or more rental units and the amount must not exceed the lowest of the following limits:

(a) The amounts set forth for new construction under the Regulations excluding the limitation applicable to Trailer Courts or Parks.

(b) 90% of the mortgagor's total cost of acquisition.

b. Refinancing Transactions. Applications involving mortgages as defined in Section 207.31 of HUD-FHA Regulations to refinance an outstanding mortgage insured under any Section of the Act shall be processed in accordance with the instructions for Mortgage Credit Analysis under Section 207-Multifamily Rental Housing except as modified herein.
(2-8) (1) The mortgage shall cover 5 or more rental units and the amount and term shall not exceed the following limits:

(a) Amount of mortgage. The mortgage amount shall not exceed the lowest of the following:

1 The original principal amount of the outstanding insured mortgagor, or

2 90% of the HUD-FHA estimate of the value of the property or project, or

3 An amount which entails a debt service (including special assessments, if any, and ground rents, if leasehold) not in excess of 90% of HUD-FHA estimate of net income, or

4 The unpaid principal amount of the existing insured mortgage, plus any other outstanding indebtedness incurred in connection with capital improvements made to the property which are acceptable to the Assistant Secretary-FHA Commissioner, the cost, as determined by the Assistant Secretary-FHA Commissioner, of capital improvements, upgrading, or additions required to be made to the property, and loan closing charges, less the lower of:

a The amount to be escrowed for reserve items scheduled for delayed replacement, plus the cost of reserve items being replaced incident to the refinancing, or

b The amount of the reserve for replacement on deposit under the existing insured mortgage.

(b) Term of Mortgage. The term of the new mortgage shall not exceed the unexpired term of the existing insured mortgage, except that in any case in which the Assistant Secretary-FHA Commissioner determined that insurance of a mortgage for an additional term will inure to the benefit of the applicable insurance fund taking into consideration the outstanding insurance liability under the existing mortgage, the new mortgage may have a term of not more than 12 years in excess of the unexpired term of the existing insured mortgage.
Amortization shall be in accordance with the provisions in the applicable administrative instructions. See reference (1) of the Foreword.

As these mortgages are on existing properties, instructions pertaining to insurance of advances normally will not apply. Cost certification is required.
3-1. GENERAL.

a. Section 103 of the Housing and Urban Development Act of 1968 added a new Section 223(e) to the National Housing Act which authorized the Secretary to insure under any Section in Title II of the Act, either single or multifamily construction, a mortgage executed in connection with the repair, rehabilitation, construction, or purchase of property located in older, declining urban areas in which conditions are such that one or more of the requirements of the Title II cannot be met. In order to insure mortgages under these provisions, the Secretary must find that the area is reasonably viable, considering the need for adequate housing for families of low- and moderate-income in the area and, in view of such consideration, that the property is an acceptable risk.

b. The purpose of Section 223(e) is to permit the use of HUD-FHA mortgage insurance in older, declining urban areas, in order to provide housing for low- and moderate-income families and to contribute to the upgrading or stabilization of such areas.

c. To accomplish these important objectives, HUD-FHA is authorized to recognize the increased underwriting risk involved and to place the insured mortgage in the Special Risk Insurance Fund rather than in the insurance funds for other Sections under which applications are submitted. In establishing the Special Risk Insurance Fund, the statute appropriates to cover any losses or administrative costs not met by reasonable premium charges.

d. Applications will be analyzed pursuant to established underwriting criteria for the program under which the application is originated. However, many properties located in older, declining urban areas will not meet normal eligibility requirements relative to property location and term of the mortgage.

e. For properties insured pursuant to Section 223(e), HUD-FHA will waive normal "economic soundness" and "economic life" requirements with respect to location and term of the mortgage, if the property is in a location which is judged to be reasonably viable, considering the need for housing for low- and moderate-income families and the objective of upgrading older, declining neighborhoods.

f. In the case of home mortgages, the term of the mortgage shall not exceed 30 years; except that, if, in the judgment of the Field Office, the mortgagor cannot qualify under a 30-year mortgage, a 35-year term may be
authorized, or up to 40 years in Section 221(d)(2) cases.

g. In the case of multifamily properties, the term shall not exceed 40 years.

h. Under these circumstances the property may be considered an acceptable risk and insured under the applicable Section of Title II pursuant to Section 223(e).

3-2. APPLICATION NUMBERING. The mortgagee's application will be submitted, received, and numbered under one of the regular Title II programs; i.e., 203(b), 221(d)(2), 207, etc. It will be noted that it cannot be determined prior to processing whether the mortgage will qualify for insurance under the Section for which application for commitment was made. If the commitment is to be issued pursuant to Section 223(e) the Field Office will strike the Section of the Act suffix code and insert the Section 223(e) suffix code. For example, if the application was submitted for processing under Section 203(b), the Section 203 code must be changed to Section 303, thus indicating that the commitment was issued pursuant to Section 223(e).

3-3. FEE AND PREMIUM COLLECTIONS. All fees and premiums for commitments issued pursuant to Section 223(e) will be collected on the same basis and at the same rate as currently provided in the HUD-FHA regulations for the program under which the mortgage could not qualify for insurance.

3-4. COMMITMENTS. All commitments for insurance under the applicable Section of the Act issued pursuant to the provisions of Section 223(e) will bear the following statement on their face, either by typing or rubber stamp:

"This commitment is issued under Section (insert applicable section) pursuant to Section 223(e)."

3-5. INSURANCE ENDORSEMENT. Upon presentment of loans for insurance endorsement, the following statement must be typed or stamped on the reverse side of HUD-FHA Form 9100-1, Mortgage Insurance Certificate, or in the endorsement panel of the note in multifamily cases:

"Endorsed for mortgage insurance under Section_________pursuant to Section 223(e)."

In home mortgages cases on the front of the insurance certificate, after the word "Section," the mortgagee must insert the Section 223(e) suffix code shown on the commitment followed by Section 223(e), for example, Section 303/223(e). Care must be taken to assure that the Section of the Act designation, and all other required items of information are correctly entered on the certificate and both underlays, and that ADP cards and
fiscal records have been reported properly.

3-6. CLAIMS FOR INSTANCE BENEFITS. All properties conveyed or all mortgages assigned to the Secretary pursuant to the provisions of Section 223(e) will be the obligation of the new Special Risk Insurance Fund and claims for insurance benefits will be settled by payment in cash.

3-7. REPORTS.

a. The number of home mortgage commitments issued each week pursuant to Section 223(e) shall be reported on the Weekly Report of Operations, FHA Form 2498, as follows:

(1) Total Number of HR*Conditional Commitments ___________________

(2) Total Number of HR*Firm Commitments ___________________

*High Risk

b. Also, each Field Office shall maintain a listing of home mortgage conditional commitments in the following format:

<table>
<thead>
<tr>
<th>Property</th>
<th>Name and Complete</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section Location</td>
<td></td>
</tr>
<tr>
<td>Case Number</td>
<td>(Complete Mortgage Address of Commitment Mortgagee)</td>
</tr>
<tr>
<td>Act</td>
<td>Amount</td>
</tr>
</tbody>
</table>

* c. This listing shall be prepared and maintained in a 3-ring binder and shall be available to the public as a register of commitments.

3-8. FISCAL INSTRUCTIONS. For fiscal instructions see references (2) and (4) of the Foreword.
CHAPTER 4. SECTION 223(e) UNDERWRITING INSTRUCTIONS - HOME MORTGAGES

4-1. COST PROCESSING. There are no special cost instructions for Section 223(e).

4-2. ARCHITECTURAL PROCESSING. There are no special architectural instructions for Section 223(e).

4-3. VALUATION PROCESSING. In the following special programs, the Underwriting Report is prepared, and processing, analysis and the application of the Minimum Property Standards is in accordance with outstanding instructions for properties submitted under Section 203(b) except as set forth below.

4-4. INSURANCE IN OLDER, DECLINING URBAN AREAS - SECTION 223(e). Section 223(e) gives HUD-FHA more flexibility in providing financing under other Sections of Title II. A mortgage may be insured under any Section of Title II, pursuant to Section 223(e) for the repair, rehabilitation, construction or purchase of properties in older declining urban areas. Section 223(e) waives "economic soundness" and "economic life" requirements with respect to location and mortgage term, but it does not waive other eligibility requirements which may be imposed by the Section of the Act under which the application is submitted. It may not be used for refinancing unless coupled with major repair or rehabilitation of the property. Major repair or rehabilitation must be distinguished from maintenance and the cost of repair or rehabilitation must equal 10 percent or more of HUD-FHA value.

4-5. FACTORS TO BE CONSIDERED IN APPROVING PROPERTIES PURSUANT TO SECTION 223(e). All home mortgage properties must be submitted by mortgagees under a standard Section of the Housing Act, usually Sections 203(b) or 221(d) (2). Under these Sections a property must be free of hazards, noxious odors, grossly offensive sights, or excessive noises which might endanger the physical improvements, affect the livability of the property or its marketability, or the health and safety of its occupants. A property must also comply with the code in code enforcement areas. Finally, a property must possess sufficient future economic life to warrant a long-term mortgage.

a. Examples of conditions which would render a property unacceptable under the standard Title II Sections include:

   (1) Hazards. Any physical condition such as unsafe construction, danger of subsidence, flooding, unstable soils, air or vehicular traffic hazards, danger from fire or explosion, inadequate water or sewerage facilities, inadequate police and fire protection in high crime locations, radiation hazards and the like.
(2) Noxious Odors. Smoke, chemical fumes, stagnant ponds and marshes may exist to a degree that the health of occupants may be affected.

(3) Grossly Offensive Sights. These may include junk yards, truck warehouses, industrial plants, sewage disposal plants, or dilapidated abandoned properties.

(4) Excessive Noises. Noises which may affect the health and peace of mind of the occupants might include heavy industrial activity, all night cafes, bars, gas stations, truck terminals, airport activity, kennels, and the like.

b. The decision to accept or reject a property affected by any of the above cited conditions, or any other conditions must be made on a case by case basis by the processors who inspects the property and its environment to determine if the property meets the eligibility criteria and the objectives of the MPS and the location criteria.

4-6. ELIGIBILITY UNDER SECTION 223(e).

a. Section 223(e) is to be used only when a property located in an older, declining urban area cannot meet the location eligibility requirements of the Section of the Act under which insurance is sought, or produces an unreasonably short mortgage term by reason of its location in an older, declining urban area which has an adverse affect upon the economic life of the property.

b. Environment factors which render a property unacceptable because of conditions which constitute a danger to the health and safety of the occupants or to the preservation of the property as recited above are not subject to waiver under action 223(e).

4-7. LOCATION. For a location to be eligible pursuant to Section 223(e) the area must be reasonably viable and able to support adequate housing for families of lower income levels. Viability means ability to live. The location features adversely affecting the desirability and usefulness of the property must not endanger the health and safety of its occupants. They cannot be ejected to terminate the useful physical life of the property over the expected life of the mortgage. Finally the property under consideration must be considered reasonably livable and marketable in light of the alternative housing available to the typical occupant of the area despite the presence of the limiting location influences.

4-8. ACCEPTABLE RISK. A second provision of the Act concerning 223(e) eligibility is that the property must be found to be an acceptable risk. Under the standard Title II Sections a
finding of economic soundness and/or acceptable risk is based upon the determination of economic life. A property with sufficient economic life to justify a long-term mortgage, which meets the property eligibility requirements is acceptable for standard Title II Sections and is, therefore, ineligible for Section 223(e). Where environmental factors so adversely affect economic life as to render the property ineligible, but the improvements are otherwise acceptable a property may be eligible under Section 223(e). The physical life of the property must be sufficient to permit the long-term mortgage. The substitution of physical life for economic life is justified because the Section 223(e) special risk provisions compensate for those environmental factors which adversely affect the property, thus permitting a mortgage of up to 30 years for single family mortgages and 40 years for multifamily mortgages if the physical life of the property will permit.

4-9. IDENTIFICATION OF ENVIRONMENTAL FACTORS.

a. When an appraiser receives an application for an appraisal and it develops that the property is located in an area that has adverse environmental factors as described in paragraph 4-5 above to the extent that rejection is proper, the application should be rejected and brought to the attention of the Chief Valuator. In rejecting conditions that render the property ineligible, the Chief Valuator will inspect the property and adjoining properties and prepare documentation including a description of the extent of the adverse factors and photos of the adverse environmental factors which cause the property or properties to be unacceptable. Care must be exercised to limit rejection only to the actual properties affected and in which it is obvious that HUD-FHA insurance would be a disservice to purchasers or mortgagors.

b. The documented file for each specific group of properties which are similarly adversely affected must be approved by and contain the concurrence of the Director of Operations in cases of multifamily property or the Assistant Director, Single Family Mortgage Insurance and the Area Office Director or the Director and Chief Underwriter of the Insuring Office.

c. Prior approval and concurrence, the Field Office Director will contact the local municipal authorities, describe the problem encountered and request that action be taken to cause correction. If the local authorities indicate any feasible program for correction of the problem in the immediate future, the application rejection will stand until such time as correction is undertaken; the final approval, however will be withheld pending a reasonable time interval so that local authority can take action. If no action takes place after a reasonable time, the
documented rejection recommendation will be sustained. (This procedure is applicable to any area including those designated for assistance (Model Cities, Urban Renewal, Code Enforcement, etc.) if not action has been or will be taken and the conditions found are unacceptable as stipulated above.)

d. The Valuator Clerk performing the initial review function should review the completed reject folder and set up an appropriate card file for future reference, logging of cases, etc. The original copy of the completed folder is to be retained in the Valuation Section Data File.

e. The instructions require identification of only those specific environmental factors which present a serious hazard to prospective occupants. This specifically does not permit any arbitrary delineation of reject areas.

4-10. CODE ENFORCEMENT AND REPAIR REQUIREMENTS.

a. The relation between HUD-FHA repair requirements and local code enforcement standards has created problems in older declining urban areas. HUD-FHA policy provides for commitment conditions assuring completion of repairs necessary to preserve the property and protect the health and safety of the occupants. This requirement reflects in a general way the intent of local housing codes, although HUD-FHA is not responsible for compliance with code requirements to the extent that local enforcement agencies are.

b. In areas where codes are in effect and are being actively enforced, the HUD-FHA commitment should require code compliance, in which case the condition on the commitment will provide for evidence from the local code authority that the property is in compliance. In this way, HUD-FHA can protect the mortgagor of modest means from the burden of bringing a newly purchased property up to code levels. HUD-FHA appraisers in these areas should be sufficiently familiar with local code enforcement operations to reflect code-induced repairs in the property valuation.

c. The appraiser will seldom have available a breakdown of work to be done to comply with a local code. When the appraiser cannot visualize the property as it will be after completion of code work, the case may be rejected and reopened after the code enforcement inspection and receipt of the statement of required repairs. It should be emphasized that the cost of code work does not necessarily affect value in a proportional amount and that HUD-FHA requirements and code requirements may be the same or they may differ in a particular case.
4-11. FINDING VALUE. Section 223(e) will expose the valuator to marginal properties and locations in which he has seldom appraised. Such properties, however, have a value and it is the valuator's responsibility to exercise his professional judgment and skill in finding that value based upon his analysis of the property, the location and the comprehensive market data which is a prerequisite to any appraisal assignment. Care should be taken to avoid value escalations influenced principally by the availability of financing in areas where financing has previously been unavailable at reasonable market terms. Special note should be taken of sales prices which have been financed previously with sales contracts or second mortgages and appropriate downward adjustment should be made in value to reflect an all cash sale to the seller. In this manner, HUD-FHA protects the mortgagor's and Secretary's interest and at the same time broadens the choices available to the public and lessens the blight on certain properties and areas that denial of financing can impose.

4-12. REPAIRS. Commitment conditions are required to insure that repairs necessary to preserve the property and protect the health and safety of the occupants are completed. Typical repair requirements in properties of the type anticipated by this Section involve plumbing, heating systems, broken or missing fixtures, rotted counter tops and floors, leaking roofs, exterior paint peeled to the bare wood, masonry crack, and the like. A property must be in sound condition so that the mortgagor shall not have an immediate burden of maintenance and repairs. In Section 223(e) cases, the appraiser will exercise special care to specify the most economical means to the end, in realization that unnecessarily expensive corrections may jeopardize the transaction. It is, of course, recognized that some properties are in such condition that rejection is the best answer for all concerned.

4-13. MORTGAGE TERM. The maximum mortgage term for a single family commitment issued pursuant to Section 223(e) shall not exceed the remaining useful physical life of the property, assuming normal maintenance and considering any proposed rehabilitation or 30 years, whichever is less.

4-14. SECTION 203 PURSUANT TO SECTION 223. Section 203 pursuant to Section 223 involves proposed sales of existing government-owned housing or the first resale thereof within two years after its acquisition from the government. Cases involving properties of not more than four living units shall be, and properties having five but not more than eleven living units may be processed under these instructions.

a. Valuation procedures relative to Section 223 vary in some respects from regular 203 processing. Processing of Section 223 projects will generally follow this sequence, with variations as necessary to conform to any special statute
pertaining to a particular disposal program:

(1) Preliminary Stage
   (a) Property Examination
   (b) Delineation of Properties
   (c) Tentative Value Estimates

(2) Appraisal and Eligibility Stage

(3) Pre-commitment Stage

(4) Compliance Stage

b. The Valuation Section will participate in conferences and work closely with the ADSF/CU, and the Land Planning, Architectural and Mortgage Credit Sections during all stages.

4-15. PRELIMINARY ANALYSIS STAGE. The Valuation Section will assemble the following appraisal data in addition to other necessary data relative to the subject proposal:

a. Outline of the public agency's proposed sales plan.

b. Data relative to maintenance and operation of public rights-of-ways and utilities.

c. Tax and hazard insurance data.

d. Current rent schedules.

e. Current operating statements.

f. Waivers of local authorities covering any code or zoning violation or, in the absence of formal waivers, some reliable evidence of early availability of such waivers.

g. Proposed protective covenants which are enforceable against the property.

h. A reasonably accurate map delineating the boundaries of the entire property and indicating its net area. Where subdivision of the project is proposed, the property survey is to show the boundaries of the parcels, the location of existing structures, street rights-of-way, and utility easements, if any.

i. Drawings of the project including site and utility plans, noted to disclose known deviations in the actual construction, or as-built drawings if they are available.
4-16. PROPERTY EXAMINATION. Valuation and Architectural Section representatives will jointly consider the physical condition of the property and the necessity, scope, and approximate cost of any proposed or required repairs, alterations or replacements necessary to put the security in sound and acceptable condition. The Valuation Section will study the neighborhood and assembled data and provide comments and conclusions in determining the general price and rent level. The current and future marketability, and the economic life of the structures will likewise be studied.

4-17. DELINEATION OF PROPERTIES. The Valuation Section will offer advice in establishing the acceptability of properties which require delineation prior to appraisal and sale as separate real estate entities. Existing or proposed easements for service lines or access will be studied to determine their affects on the utility and marketability of the property. Proposed dedication of streets, walks, and other public areas or easements, the assumption by a public body of responsibility for maintenance of such dedicated areas, and the acceptability of the proposed disposition of utility systems shall be considered carefully.

4-18. TENTATIVE ESTIMATES OF VALUE. The Valuation Section will prepare tentative estimates of value for use in final pre-application conferences. Sample appraisals on carefully selected typical sales units will be made.

4-19. APPRAISAL AND ELIGIBILITY STAGE. FHA Form 2800-3 and 2017A will be used in processing as per current instructions for Section 203 processing. Since these properties may be in a different sales price and rental range from that ordinarily considered in HUD analyses, data available in office files on competitive properties may be limited. Therefore the collection of applicable and relevant market data in the price range under consideration will be of prime importance. Likewise, the analysis of such comparative data should take into consideration the fact that properties in these price and rental categories may be appropriately equipped on a level less exacting than would normally be required in new construction.

4-20. MORTGAGE CREDIT PROCESSING.

a. A mortgage financing the repair, rehabilitation, construction or purchase of a property located in an older, declining urban area shall be eligible for insurance under any Section of Title II of the National Housing Act provided it meets the requirements set forth below. The mortgage shall be insured pursuant to Section 223(e).

b. Mortgage Insurance Requirement. The mortgage shall meet
the underwriting criteria of the Section of the Act under which insurance is requested, except that any requirements relating to economic life and economic soundness will not apply. It must be found that:

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(4-20)    (1)  The area is reasonably viable, considering the need for adequate housing for families of low and moderate income in the area and;

(2)  In view of such consideration, the property is an acceptable risk.

c.   Mortgage Credit Home Mortgage Procedures and Analysis. Follow outstanding instructions for the Section of the Act under which insurance is requested. All statutory, regulatory and mortgage credit limitations shall be applied except that the limitation on the term of mortgage of 75% of the remaining economic life of the building improvements is not applicable. In lieu thereof, a limitation of 100% of the physical life of the property will apply. Since the purpose of Section 223(e) is to make properties in older, declining urban areas eligible for insurance, waiver of FHA requirements will normally involve the property and location only. Mortgagors must meet credit, income, and minimum investment criteria pertinent to the Section of the Act under which insurance is requested.

d.   Multifamily Mortgage Credit Procedures and Analysis. Follow outstanding instructions for the Section of the Act under which insurance is requested. All statutory, regulatory and mortgage credit limitations shall be applied except that the term of the loan shall not exceed 40 years or 100% of the estimated physical life of the property. Since the purpose of Section 223(e) is to make properties in older, declining urban areas as well as riot-threatened areas eligible for insurance, waiver of HUD-FHA requirements will normally involve the property and location only. Mortgagors must meet credit standards, financial requirements, and maximum mortgage criteria pertinent to the Section of the Act under which insurance is requested.
CHAPTER 5. SECTION 223 (d)

5-1. VALUATION PROCESSING.

   a. Request for 2 Year Operating Loss Pursuant to Section 233(d). As directed by the Assistant Director Technical Services Branch/Chief Underwriter (ADTSB/CU) the Valuator will render service and assistance in support or rejection of the proposed application. Preliminary discussion, in conference with the sponsor, will develop general outlines and provide guidance to the applicant. Information supplied by the applicant will be reviewed and analyzed using data available through office records and general current working knowledge of the project and background.

   b. Upon receipt of an application and authorization of the ADTSB/CU the appraiser shall complete a narrative in memorandum for covering the following:

      (1) City-wide Data - Present occupancy ratios pertinent to the Section of the Act project was processed under.

      (2) Neighborhood Data.

         (a) Income of residents.

         (b) Age and condition of residential structures.

         (c) Current absorption data pertaining to project.

         (d) Current occupancy ratios.

         (e) Competitive projects and their rentals.

         (f) Volume of competitive constructions underway.

         (g) Other pertinent facts having a bearing on the project.

   c. The appraiser will support his conclusions as to the forecast of continued occupancy or the rent levels predicted. The information set forth will reflect current conditions and will be prepared independently of any findings used in the original processing.

Facts and figures supplied by the sponsor are interesting only as guides and are not to be used except as they are fully substantiated by findings in the market and from unrelated sources. Comparison with similar and competing projects must be made to determine the quality and efficiency of the project management.

(1) An accurate appraisal of the situation is required.
5-2. MORTGAGE CREDIT ANALYSIS. Pursuant to the provisions of Section 223(d) of the National Housing Act as amended (and the applicable FHA Regulations for the Section of the Act under which the multifamily project is insured), the mortgagor may request and the Assistant Secretary-FHA Commissioner may insure a loan to cover the excess of taxes, interest, mortgage insurance premiums, hazard insurance premiums and the expense of maintenance and operation of the project over project income during the first two years following the date of completion of the project. Payments of principal in the mortgage debt are not included in calculating the excess. The loan shall be secured by an additional instrument in a form approved by the Assistant Secretary-FHA Commissioner for use in the jurisdiction in which the project is located.

a. To be eligible for consideration for an operating loss loan, it must be found that all six of the following conditions are present:

1. Two years have elapsed since the date the final project Inspection Report, FHA Form 2449, was signed by the Field Office, Chief Architectural and Engineering Section/Chief Architect;

2. An allowable loss has been experienced; and

3. Sustaining occupancy has been attained or there is every indication that sustaining occupancy will be attached at a predictable date in the immediate future (in most cases 18 months or less); and

4. The mortgagee has assented in writing to the loan to cover operating losses; and

5. Final endorsement of the mortgage was subsequent to May 31, 1957; and

6. The competence and responsibility of the project management have been established to the satisfaction of HUD-FHA.

b. When it has been determined through preliminary discussions that all the eligibility conditions are present, a tentative estimate of the maximum loan will be made as a test of feasibility. This will be accomplished by determining the maximum insurable amount (existing mortgage and operating loss loan) that will entail a debt
service not in excess of the annual net income based on the Valuation Section’s current estimate of present or projected total annual rentals and expenses assuming 90% occupancy. Calculations will be as follows:

Step 1. Multiply the total annual rent by 90%.

Step 2. From the amount determined in Step 1, subtract the total annual operating expenses (including reserves for replacements) taxes, annual ground rent, if leasehold, and special assessments, if any.

Step 3. From the amount of net income determined in Step 2, deduct the amount of the current annual debt service requirements on the mortgage based on 12 times the current monthly payment for principal interest, and mortgage insurance premium.

Step 4. The tentative maximum operating loss loan is obtained by dividing the residual income determined in Step 3 by the debt service rate for the loan based on the current interest rate and a term which normally will be the remaining term of the original mortgage. The appropriate initial curtail rate shall be obtained from FHA Form 3010. (See reference (1) of the Foreword. Multiply the monthly installments therein given by 12.

(5-2) c. When a formal application is made it must be accompanied by financial statement prepared by independent certified public accountants or independent public accountants in conformity with the guide lines set forth in the instructions for accountants, FHA Form 771. The statements will be reviewed jointly with the Valuation Section with particular attention to conformity with the required certification and to the consistency and plausibility of all income and expense items. Any items not recognized as an appropriate expense of the project and any items which appear excessive shall be brought to the attention of the DO/CU. Further processing shall be held in abeyance pending receipt of written instructions as to the disposition of such items.

d. After reconciliation of all statements, adjustments to the statements as may be necessary, and establishment of the operating loss, the maximum insurable loan shall be the lowest of the following:

(1) The amount of operating loss loan requested.
(2) The amount of operating loss established.

(3) The maximum operating loss loan based on debt service limitations.

Determine as follows and record conclusions in a memorandum to the file.

Step 1. Multiply the Valuation Section's estimate of current or projected net income by the applicable ratio of debt service to net income for the Section of the Act under which the project is insured. Where there is a 90% limitation, the percentage may be increased up to 95% if the Field Office Director believes such an increase is warranted.

Step 2. From the amount of net income determined in Step 1, deduct the amount of current annual debt service requirements on the outstanding mortgage (the same as in tentative computations).

Step 3. The maximum operating loss loan is obtained by dividing the residual income determined in Step 2 by the debt service rate for the loan (the same as in the tentative computation).

e. If at the time of approval of the operating loss loan, sustaining occupancy has not been achieved, all or such portion of the loan as may be necessary shall be held in escrow to meet operating deficiencies until the project is self-sustaining. Releases of funds from the escrow in accordance with terms of the escrow agreement shall be effected only with prior approval of HUD-FHA.