
CHAPTER 11. MORTGAGE CREDIT PROCEDURES

- 11-1. INTRODUCTION. Mortgage Credit procedures and analysis are to be completed in accordance with Section 207 basic instructions, Reference (10) of the Foreword except as herein modified.

Mortgage insurance under Sections 213 and 221(d)(31) Market Interest Rate of the National Housing Act provides a program for the construction and acquisition of housing by cooperative organizations specifically formed for this purpose. Projects must include 5 or more dwelling units to be eligible for processing.

- 11-2. GENERAL. Mortgage Credit analysis of management type cooperative projects proceeds logically in the steps listed below:

- a. Determination of amount and amortization period of Loan (Issuance of Commitment).
- b. Determination of Estimated Requirements for Completion of Project.
- c. Credit Investigation.
- d. Analysis of Acceptability of the Member Cooperators.
- e. Determination of Acceptability of the Cooperative Organization.
- f. Assurance of Completion (initial Endorsement of Mortgage).
- g. Insurance of Advances.
- h. Construction Changes.
- i. Cost Certification (Final Endorsement of Mortgage).

NOTE: In order to orient the above steps with the over-all progress of the project certain steps are listed in parentheses that are not part of Mortgage Credit analysis.

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- 11-3. AMOUNT AND AMORTIZATION PERIOD OF LOAN. The initial step in Mortgage Credit processing subsequent to receipt of an application involves the determination of amount and amortization period of loan. The amount of mortgage loan will be the amount applied for but not to exceed the maximum amount permitted under the statutory

and regulatory limitations under Section 213 of the National Housing Act. The mortgage should involve a principal obligation in an even multiple of \$1.00.

- * a. Amount of Loan - New Construction. This includes all projects not involving rehabilitation or reconstruction of existing structures or existing construction. Insurable mortgage amount will not exceed the lowest of:
- (1) 98% of the total estimated replacement cost of the property or project.
 - (2) An Amount Attributable to dwelling use excluding exterior land improvements not to exceed:
 - (a) Other than Elevator Type Structures.
 - \$13,000 per family unit without a bedroom.
 - \$18,000 per family unit with one bedroom.
 - \$21,500 per family unit with two bedrooms.
 - \$26,500 per family unit with three bedrooms.
 - \$30,000 per family unit with four or more bedrooms.
 - (b) Elevator Type Structures.
 - \$15,000 per family unit without a bedroom.
 - \$21,000 per family unit with one bedroom.
 - \$25,750 per family unit with two bedrooms.
 - \$32,250 per family unit with three bedrooms.
 - \$36,465 per family unit with four or more bedrooms.

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- * b. The Mortgage Amount may exceed the limits stated in (2)(a) and (b) above by not more than 98% of the cost not attributable to dwelling use including exterior land improvements.
- c. The Assistant Secretary-FHA Commissioner may increase the foregoing per family unit dollar amount limitation by not to exceed 45% in any geographical area where he finds cost levels

so require.

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11-4. REHABILITATION. See Reference (20) of the Foreword.

11-5. DETERMINATION OF ESTIMATED REQUIREMENTS FOR COMPLETION OF THE PROJECT.

- a. The determination of the maximum insurable mortgage is accomplished by completing Part I of FHA Form 2264-A.
- b. Part II of this form details the Total Requirement for Project Settlement. Funds required for cash investment, initial operating deficit, commitment fees, marketing fees, working capital, discount(s) and off-site construction costs are set forth.
- c. Part III reflects the source of funds to meet project cash requirements. FHA Form 2264-A is completed in accordance with instructions in Reference (10) of the Foreword.

11-6. CREDIT INVESTIGATION.

- a. Cooperative Membership Exhibit. Subsequent to issuance of commitment and prior to the setting of a date for closing, the mortgagee must submit a statement of the cost to the mortgagor and the Cooperative Membership Exhibit, FHA Form 3203, in duplicate. The number of members must equal the percentage (or number) of the total number of units as specified in the commitment.
- b. Data on Co-op Members. The Cooperative Membership Exhibit includes a statement showing the name of each proposed member of the cooperative, the type of dwelling unit he will occupy, the unit cost to the member, total amount of downpayment required, and the amount of monthly charge to each member to

(11-6) cover debt service, cooperative operating expense, reserves, taxes, special assessments, and ground rents, if any. This statement must be signed by a responsible officer of the cooperative. To this exhibit must be attached a: (1) credit report on each individual listed therein; (2) signed personal financial statement; (3) verification of employment (FHA Form 2004-g); and (4) verification of bank or other depository (FHA Form 2004-f). The personal financial statements should be prepared on FHA Form 3232-A, Supplement to Subscription Agreement. The intent of the member with respect to occupancy of the unit must be clear. Proposed members who intend to

occupy the dwelling unit on a transient basis are not eligible. The proposed member must indicate his intention to occupy the cooperative unit as soon as it is available either as his principal or secondary home. When it is to be occupied as a secondary home the size of the unit should be sufficient to meet the reasonable needs of the family involved on a year around basis. No consideration may be given to any anticipated income from a unit to be occupied as a secondary home.

- c. Group Acceptability Information. The Cooperative Membership Exhibit provides information regarding acceptability of the group as determined by credit standing and paying ability of the members. If the exhibit is incomplete, additional information or verification should be requested. Both copies of this exhibit, together with any other credit data which are collected should be placed in the Credit Binder for the proposed Section 213 project.
- d. Membership Motivation. In order to determine the acceptability of a cooperative ownership housing project, reliance is placed on the motivation of the members of the cooperative who own and occupy the project rather than the rental housing criterion of an excess of net income over debt service requirements.
- e. Member's Credit Standing. It is necessary to examine credit reports on the individual members (subscribers) and their personal financial statements (submitted on FHA Form 3232-A) in order to determine their credit standing, ability to pay and stability of employment.

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- (11-6) f. Stability of Effective Income and Cash Investment Requirements. Stability of effective income is related to the initial term of the occupancy agreement, and the ability to meet the required investment in the project which may not be less than 3% of the unit cost, as verified in Article 9 of the Information Bulletin FHA Form 3241, including any working capital deposit.
 - g. Net Effective Income. An estimate of the net effective income of each member should be made, and compared with the prospective monthly housing expense for the type of unit to be occupied. The stability of the members' effective income will be related to the initial term of the Occupancy Agreement rather than the early period of risk under the mortgage. As Occupancy Agreements are binding for a term of three years, the member should give evidence of a continuing effective income for at least this three year period in an amount which bears a reasonable relationship to the monthly housing expense

and other fixed obligations.

- h. Prospective Monthly Housing Expense. Prospective monthly housing expense will be calculated by adding personal benefit expense for the type of unit to be occupied to the monthly charge listed on cooperative membership exhibit. Personal benefit expense is obtained from Section I on FHA Form 2264-B. Effective incomes of members who propose to occupy the living units in the various price ranges should bear proper relationship to prospective monthly housing expense as indicated by Reference (1) of the Foreword. A notation should be made opposite each name on the original copy of the exhibit to indicate amount of cash available for investment, effective income of the member, total housing expense for type of unit to be occupied, and which members, if any, do not meet minimum requirements with respect to credit standing, ability to pay, stability of employment, and ability to make the required investment. The duplicate copy of this exhibit will be completed in a similar manner by typing these items of information thereon and will be sent to the Central Office for attachment to the commitment.
- i. Acceptability of Co-op Membership. The number of members or persons agreeing to become members of the proposed mortgagor corporation at this time must equal the minimum number of members specified in the commitment except as set forth in Chapter 1, paragraph 1-7. of this Handbook. All of these

members or proposed members must be found acceptable, before approval of the mortgagor can be recommended, from the standpoint of ability to take their required investment, ability to pay the necessary monthly charges, and previous credit record. When analyzing the cooperative membership, all of the members or proposed members in addition to all other requirements must be found acceptable from the standpoint of their ability to make their required investment in the cooperative in accordance with Reference (1) of the Foreword (Chapter 1, paragraph 1-25.c.). Analysis is made of the paying ability and credit standing of each member in order to determine acceptability of the group.

- j. Unacceptable Co-op Membership Candidates. Individual who for any reason are considered unacceptable cannot be approved as members of the proposed mortgagor corporation. The Mortgage Credit Examiner prepares a schedule for the Director listing the names of individuals who do not qualify and indicating the reasons why they cannot qualify as members. If, as the result of some rejections, the number of approved individuals

equals less than the minimum number of members required under the terms of the commitments this schedule should also indicate the number of additional members to be obtained before approval of the mortgagor can be recommended.

- k. Substitute Co-op Member(s). If any of the originally approved members re-sell or cancel their stock subscription prior to final endorsement, the substituted member must receive HUD-FHA credit approval. In all instances the above language must be incorporated as a commitment requirement.

11-7. DETERMINATION OF ACCEPTABILITY OF THE COOPERATIVE ORGANIZATION.

- a. Ability to Close. After analysis of the credit acceptability of the individual cooperators but before endorsement for insurance it must also be determined that the cooperative organization has the ability to close the transaction in a satisfactory manner and that the sum of the monthly charges to members will be adequate to meet debt service and other ownership expense.

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- (11-7) b. Capacity to Provide Additional Funds. It must be determined that the present members of the cooperative, as a group, have the ability to provide whatever additional funds may be required to close the transaction by reason of the fact that 100% membership may not have been obtained at this time for projects involving insurance of advances during Construction. The financial requirements in connection with the entire project and the determination of the ability of the proposed cooperative organization's ability to meet these requirements are recorded on FHA Form 2264-A. The Form is completed in accordance with instructions in Reference (10) of the Foreword.
- c. Adequacy of Monthly Charges. It is also necessary to determine that the sum of monthly charges, as listed on Cooperative Membership Exhibit, converted to an annual basis, is sufficient to meet the HUD-FHA estimate of debt service, cooperative operating expenses, taxes, special assessments and ground rents, if any, plus a general operating reserve of 3% of these items. In making these determinations allowances for accessory income, if any, shall not exceed the cooperative's estimate or the HUD-FHA estimate of accessory income, whichever is the lesser. However, rentals payable under duly executed acceptable leases for commercial space on the premises shall be used in lieu of estimates. These should be totaled to be sure all members have assurance that the total membership have their required minimum equity requirements.

(1) The HUD-FHA estimate of annual charges will include the

following:

- (a) Debt Service (Mortgage amount X percent of debt service).
 - (b) Cooperative Operating Expenses, Reserve for Replacements, Taxes, Special Assessments and Ground Rent, if any.
 - (c) (Memorandum attached to FHA Form 2264). General Operating Reserve of 3% of Sum of Above.
- (2) The total debt service will be calculated by multiplying amount of mortgage by sum of initial curtail rate, interest rate and 1/2% mortgage insurance premium. Cooperative Operating Expense includes those operating

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expenses, reserve for replacements, taxes, special assessments and ground rents, if any, which are the responsibility of the cooperative membership as a whole rather than of the individual members. These expenses will include the cost of occupancy of the units assigned to janitor use. These expenses are obtained from the memorandum prepared by the Valuation Section and attached to FHA Form 2263. The General Operating Reserve is 3% of the sum of the annual charges described above, and is accumulated as a special reserve in order to meet possible contingencies.

- 11-8. FINANCIAL REQUIREMENTS FOR CLOSING. The accumulation of the necessary data to provide the closing attorney with accurate and final financial details needed to close the mortgage transaction necessitates the initiation of direct inquiries to the cooperative organization. The information to be requested will include the amount of the construction contract, the contractor's fee, the architect's fee and the amount of contract for off-site improvements, if any. These figures will be subject to such modifications as are necessary to conform to the actual contracts and financial details agreed to at closing between the parties to the transaction. These data are required only in those cases involving the insurance of advances of mortgage proceeds and are recorded on FHA Form 2283-c, in accordance with instructions in Reference (10) of the Foreword.
- 11-9. ASSURANCE OF COMPLETION. At the initial closing of a Section 213 project involving the insurance of advances a satisfactory assurance of completion must be provided in accordance with the HUD-FHA Regulations.

11-10. INSURANCE OF ADVANCES. Follow instructions outlined in Reference (10) of the Foreword.

11-11. CONSTRUCTION CHANGES. Construction change procedures are to be completed in accordance with Section 207 basic instructions cited above, except as herein modified for Section 213.

- a. Request for consideration of proposed construction changes will be initiated on FHA Form 2437 as in Section 207 projects. However, the provisions applicable to Section 213 Management and Sales Type on the reverse side of the form must be completed by the contractor mortgagor. These provisions provided for the contractor to state if he agrees to assume any additional cost resulting from the proposed changes and for the mortgagor to indicate the amount of increase or decrease, if any, in the construction contract.

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- b. When the provision indicates an increased cost to be paid by the mortgagor, a cash deposit is required as a condition for approval of the change. The amount of the deposit will be the difference between the increased amount of the construction contract and the original contract price except, when the HUD-FHA estimate indicates a net increase of \$2500 or more, the amount to be deposited will be the amount of the HUD-FHA estimated net increase in cost or the amount of the increase in the contract amount, whichever is greater.

11-12. COST CERTIFICATION. The FHA Regulations under Section 213 (Management Type) require the mortgagor to execute a certificate upon completion of the construction of a property or project involving proposed construction or the rehabilitation of existing construction as to the actual cost of the completed property or project.

- a. Allowable Cost. Mortgage credit analysis of allowable costs shall be performed in accordance with basic Section 207 procedures cited above, except as modified herein.

Construction cost. If the original amount of the Construction Contract, Lump Sum, FHA Form 2442, has been increased pursuant to the provisions of Article 13 thereof, the increased amount of the contract should be entered on FHA Form 2330, but the Field Office should satisfy itself that the computation has been correctly made.

- (2) Off-site cost. Actual cost to the cooperative mortgagor under a supplemental arm's length lump sum contract for

off-site improvements is allowable, and should be entered separately on FHA Form 2330, Item 12.

- (3) Legal, Organization Development Services and Marketing Expense. Reasonable and necessary legal and organizational expense incurred in the organization of the mortgagor, and initial closing, cost certification fee, and final closing, and settlement of legal questions or litigation arising in connection with organizing the cooperative project are allowable.

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- (11-12) (a) The largest expense is usually in connection with organizing the cooperative, including not only the preparation of the formal documents for "Development of Mortgagor Corporation," but solicitation for memberships normally involving the formation of a sales office, printing of brochures, advertising, equipping and furnishing of model units and lobby and other public spaces, salesmen's commissions, etc.
- (b) However, insofar as furnishings of model units is concerned, there should be deducted from the cost thereof any salvage value of such equipment. Public space furnishings should remain the property of the cooperative. Whether or not the amount allowed as the actual expense exceeds the HUD-FHA estimate thereof in FHA Form 2264-B, the burden of proof as to the reasonableness and necessity of the expenditures will be on the mortgagor, and the Director will require such itemization as he considers necessary.
- b. Occupancy During Construction Period. In some cases occupancy may be obtained before the cutoff date for inclusion of interest, taxes, mortgage insurance premium and property insurance premiums in certifiable cost. In these cases a statement shall be required showing:
- (1) Gross occupancy income collected during the period from first occupancy to the cutoff date.
 - (2) Actual Operating expense during the same period.
 - (3) Operating expenses for this purpose shall include advertising expenses, sales commissions paid, a reasonable management fee, and electricity, gas, water, and operating salaries (Maintenance, cleaners, gardeners,

elevator operators, etc.) to the extent they are not properly included in construction costs on FHA Form 2330 and 2340-A.

- (4) If this statement produces an excess of income, the excess shall be treated as a recovery of construction costs and shall be entered on Line 15 of FHA Form 2330 and considered as a disallowance in Schedule 1, FHA Form 2580, under Net Income During Construction Period.

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- (11-12) (5) As an alternative to the foregoing, the parties may at their option deposit the excess income in the Reserve for Replacements.
- c. Escrowed Funds. The Field Office Director will not approve release of any escrowed funds without a satisfactory certification of work except that an accountant's certification will not be required. Allowable costs shall be determined in accordance with basic instructions except that any required prepayment on the mortgage may instead be placed in the Reserve for Replacements Funds at the election of the mortgagor.

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