CHAPTER 2. PROGRAM REQUIREMENTS

2-1. ELIGIBLE SRO PROJECT. SRO projects must meet the following eligibility requirements:

A. Projects must be either new construction or substantial rehabilitation.

B. Projects must be comprised primarily of one room units. Bathroom and kitchen facilities are not required within the units, but may be included at the owner's option, subject to the procedures in paragraph 4-2. Shared kitchen and bathroom facilities are also permitted, subject to the procedures in paragraph 4-3.

C. Projects must contain five or more units and be comprised of detached, semi-detached, walk-up, row houses or elevator structures.

D. Development can be on noncontiguous (scattered) sites provided the building sites are in the same immediate area, the buildings comprise a reasonable management entity, and the project as a whole meets all financial and programmatic standards for approval.

E. Projects must be designed primarily for residential use. Any commercial activity must be compatible with the use of the project and primarily for the benefit of the residents. Commercial space will be limited to:

   1. 10 percent of the total gross floor area (20 percent in substantial rehabilitation cases), and

   2. 15 percent of gross rental income in a project.

2-2. INELIGIBLE SRO PROJECT. An SRO project is not eligible when:

A. The project application is for mortgage insurance for the purpose of refinancing or purchase of an existing facility and substantial rehabilitation is not required.

B. The project is subject to State licensure, certification or regulation as a board and care home (or similar residential care facility).

C. The project provides central kitchen or dining facilities for providing food services to tenants.
D. The project restricts occupancy to particular groups such as students.

2-3. SUBSTANTIAL REHABILITATION CRITERIA.

A. Substantial rehabilitation proposals must meet one of the following criteria:

1. The cost of repairs, replacements, improvements exceeds 15 percent of the total estimated replacement cost of the project.

2. At least two major building components are being substantially replaced. The term "major building component" includes: roof structures; ceiling, wall or floor structures; foundations; and plumbing, heating and air conditioning systems; or electrical systems.

   a. Major refers to the importance of the component and the extent of replacement.

      (1) The element must be significant to the building and its use, normally expected to last the useful life of the building, and not minor or cosmetic.

         Examples:
         Major - roof sheathing, rafters, trusses.
         Minor - shingles, built-up roofing.

      (2) Total replacement is not required, but the greater part (at least 50 percent) must be replaced.

      (3) The term "major" provides a great deal of latitude and, therefore, good judgment is necessary and expected.

   b. HUD architectural staff will make the determination.

B. Additions are permitted in substantial rehabilitation projects; however, the construction costs of additions are not to be included when determining eligibility under A.1. above and additions are not to be considered a major building component under A.2.
C. A limited number of units larger than one room can be included in substantial rehabilitation projects; however, the maximum number shall not exceed 5 percent of the total number of units in a project, excluding nonrevenue producing units.

D. Enclosed kitchens are permitted in some substantial rehabilitation project units which meet the requirements of paragraph 4-2 (B)(1), and as a common use (shared) kitchen of modest design which meets the square foot floor area limitation of paragraph 4-3 (F)(1).

E. A enclosed kitchen shall be considered a separate room; however, a bathroom shall not be considered a room, even when enclosed.

2-4. REAL ESTATE REQUIREMENTS. The mortgage must be on real estate held:

A. In fee simple;

B. Under a renewable lease for not less than 99 years.

C. Under a lease having a period of not less than 10 years to run beyond the maturity date of the mortgage.

2-5. FURNISHINGS AND EQUIPMENT. See also paragraph 3-2 B.

A. Major Movables. The Sponsor must submit two separate lists of major movable equipment and furnishings as follows:

1. Eligible to be included in replacement cost. Large furniture and/or equipment having a relatively fixed location, but capable of being moved, necessary to the function of the facility and for use in common areas. Examples: office and lobby furniture, sofas and chairs for lounger and copy machine.

2. Ineligible to be included in replacement cost. Unit furnishings: bed with mattress, desk/table, chair, and dresser. These items must be provided by the Sponsor for each SRO unit.

B. Other Furnishings or Equipment. If the Sponsor plans to offer such items as television, microwave oven, telephone, etc., for an additional fee, a list of items including proposed charges shall be submitted to HUD at
the initial commitment stage. Rental of such items cannot be a condition of occupancy and their cost is not eligible for inclusion in replacement cost.

C. A reserve for replacement for major movable items which are eligible to be included in replacement cost must be established in accordance with the instructions of paragraph 4-15.

D. Replacement Reserve for Unit Furnishings. The Field Office shall assure that the firm commitment contains the following conditions:

1. The mortgagor shall establish and maintain a reserve fund for nonrealty unit furnishings. The amounts for the annual deposits to the replacement reserves for realty and nonrealty items will be computed separately.

   a. Replacement Reserve for Realty Items. Insert the amount of the annual deposit in the commitment. Reflect the required monthly deposit in the Regulatory Agreement.

   b. Replacement Reserve for Nonrealty Items.

      (1) Condition the commitment to provide for a separate annual deposit for the nonrealty unit furnishings.

      (2) At the initial closing, amend the Regulatory Agreement to provide for a separate monthly deposit for the nonrealty items. The amendment must state that failure to fund this reserve is not a basis for declaring a technical default.

2. The Owner(s) shall execute a Security Agreement and Financing Statement (or other form of chattel liens) upon all items of equipment, except as the Secretary may exempt, which are not incorporated as security for the insured mortgage. The Security Agreement and Financing Statement shall constitute a first lien upon such equipment and shall run in favor of the mortgagee as additional security for the insured mortgage.

2-6. LIENS AND MORTGAGE SECURITY. The mortgagor must certify at endorsement (initial and final endorsement for insurance of
advances) that:

A. The mortgage is a first lien and covers the entire project, including the equipment financed with mortgage proceeds.

B. The property upon which the improvements have been made or constructed and the equipment financed with mortgage proceeds are free and clear of all liens other than the HUD-insured mortgage and such other liens as may be approved by HUD.

C. Furniture and equipment in replacement cost, even if paid for by the mortgagor, must be included and covered by a security agreement or other instrument, creating a security interest made to the mortgagee. No leasing or lease purchase agreements are permitted for these items.

2-7. Restriction Against Change of Use. The mortgage note and Regulatory Agreement shall contain a covenant which provides that unless written approval is received from the Commissioner, an owner (or any successor owner) of an SRO project insured under Section 221(d), pursuant to Section 223(g) of the National Housing Act, may not change the use of the project from that of an SRO rental facility for a period of 20 years, commencing at final endorsement of the mortgage for insurance. This use restriction shall pertain irrespective of whether the mortgage is prepaid by the mortgagor within the 20-year period.

2-8. DISPLACEMENT.

A. General. Applications under multifamily mortgage insurance programs, such as the Section 221(d) program for SROs, do not trigger the requirements of the Uniform Relocation Act (URA), unless some other aspect of the proposal is covered by the URA. However, HUD's policy is to minimize displacement of tenants in its programs. The Sponsor's relocation plan must identify the estimated cost of the relocation as well as the funding sources.

B. Replacement Cost Allowance for Relocation. A maximum of $500 per unit will be allowed in the HUD determined replacement cost. Needed funds in excess of this amount must be provided from other sources and placed in escrow at initial endorsement.

2-9. MORTGAGORS.
A. Eligible mortgagors under the SRO procedures are:

1. Nonprofit.
   a. An entity organized for reasons other than financial gain and which the lender finds is not controlled or directed by persons or firms seeking financial gain from it. Its operation must be regulated under Federal or State law. Nonprofit mortgagors can be private nonprofit or public nonprofit mortgagors.
   b. If a nonprofit corporation is to be formed, the provisions of Form FHA 3433, Request for Determination of Eligibility as Nonprofit Sponsor and/or Mortgagor, should be reviewed and discussed with Field Office staff.

2. Builder-seller. An entity organized to:
   a. Build or rehabilitate a project and which, by written agreement with a nonprofit mortgagor, will sell it (at final endorsement) to that mortgagor for no more than the HUD-approved certified cost;
   b. Operate the project (subject to regulation by the lender) according to HUD requirements until sold to the nonprofit mortgagor; and
   c. Operate the project as a limited distribution mortgagor if it is not sold within 2 years to a nonprofit mortgagor.

3. Limited distribution. An entity restricted by Federal or State law as to rate of return and other aspects of its operation.

4. General. Any mortgagor approved by the lender that does not meet any of the definitions in 1 through 3 above. Profit-motivated mortgagors are general mortgagors.

5. Public Mortgagors. A Federal instrumentality, a State or political subdivision thereof, or an instrumentality of a State or a political subdivision thereof, which certifies that it is not receiving financial assistance from the United States exclusively pursuant to the U.S. Housing Act of 1937, which is nonprofit and acceptable to HUD. If a particular public body's sole source of
Federal aid is from the U.S. Housing Act of 1937, such public body will not qualify as a mortgagor. Further, the fact that a public body may receive State or local funds does not change the situation. Such mortgagors shall be regulated or supervised as to rents, charges and methods of operation in such manner, as in the opinion of the Commissioner, will effectuate the purposes of the legislation.

B. Ineligible mortgagors. The following mortgagors are not eligible under SRO procedures:

1. Cooperative mortgagors. A nonprofit cooperative ownership housing corporation that restricts permanent occupancy to members of the corporation and requires membership eligibility and transfer of membership.

2. Investor-Sponsor mortgagors. An entity organized as is a builder-seller mortgagor (paragraph A, above) and is subject to the same restrictions, except that the project will be sold to a cooperative rather than a nonprofit mortgagor.

C. Supervision of Mortgagors:

1. All mortgagors must be approved by HUD and regulated through a Regulatory Agreement.

2. Mortgagors must be single asset mortgagors.

2-10. OCCUPANCY. Residents of SRO projects are subject to normal tenant selection procedures. There are no upper income limits for admission to insured SROs. Due to the nature of the SRO projects, it is expected that the tenancy will be largely low and moderate income persons. In addition to any local government occupancy requirements, the following occupancy requirements apply:

A. A unit must be the primary residence of the occupant(s).

B. Residents must execute a minimum 30-day lease. However, rent collections need not be on a monthly basis but may not be collected more frequently than weekly.

C. If more than one person occupies a unit and one of the occupants is a minor, the local government may require
that the other occupants be parentally (including legal guardians) or ancestrally related to the minor.

2-11. CIVIL RIGHTS REQUIREMENTS. Each Mortgagor/Owner must certify to the Commissioner that:

A. It will: 1) comply with the Fair Housing Act and implementing regulations (24 CFR Part 100) and administrative procedures that prohibit discrimination because of race, color, religion, sex, national origin, familial status, or handicap; 2) comply with Executive Order 11063; 3) administer the project and related activities to further fair housing in an affirmative manner; and 4) comply with State and local fair housing laws;

B. The site and neighborhood shall be suitable from the standpoint of facilitating and furthering full compliance with the applicable provisions of Title VI of the Civil Rights Act of 1964, the Fair Housing Act, Executive Order 11063 and implementing HUD regulations;

C. Neither it, nor anyone authorized to act for it, will refuse to sell or rent, after the making of a bona fide offer, or refuse to negotiate for the sale or rental of, otherwise make unavailable or deny the property covered by the mortgage to any person because of race, color, religion, sex, familial status, or national origin, or to discriminate against any person in the sale or rental of a dwelling because of handicap;

D. Any restrictive covenant on such property relating to race, color, religion, sex, familial status, or handicap is recognized as being illegal and void and is hereby specifically disclaimed;

E. Preventive relief may be sought through the Department's administrative proceedings before an Administrative Law Judge pursuant to the Fair Housing Act, or by civil action through the U. S. District Court against any person responsible for a violation of this certification;

F. Marketing will be done in accordance with the HUD approved Affirmative Fair Housing Marketing Plan and regulations at 25 CFR Part 200, subpart M;

G. It will not use tenant selection procedures that discriminate against persons because of race, color, religion, sex, national origin, handicap, or familial status; and
H. Records containing information on the race, ethnicity, and gender of program applicants and participants will be maintained and available for inspection by the Secretary's designee.

2-12. DETERMINING LOAN AMOUNT AND AMORTIZATION PERIOD. Analysis of the credit risk is based on a loan for a definite amount and amortization period.

A. The mortgage will be a principal obligation stated in multiples of $100.

B. The amortization period will be 75 percent of the estimated remaining economic life of the physical improvements or 40 years, whichever is less.

C. Projects offered for security must be designed principally for residential use and have at least five SRO units.

2-13. AMOUNT OF LOAN - NEW CONSTRUCTION. Includes construction of all types of projects (excluding rehabilitation). The insurable amount is the least of:

A. Application Amount.

B. Applicable percentage of HUD's estimate of the replacement cost after completion, less the amount of grant/loan funds attributable to replacement cost items.

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C. Debt service that does not exceed the applicable percentage of the estimated net income. The mortgage may exceed this limit by capitalizing the savings from any tax abatement.

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D. Construction cost attributable to dwelling use, excluding exterior land improvements, not to exceed:

1. For walk-up structures:
a. Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3) of the Act, the per family unit limits are found in 24 CFR 221.514(a)(1)(i).

b. Projects involving eligible mortgagors other than nonprofit mortgagors to be insured under Section 221(d)(3) of the Act, the per family unit limits are found in 24 CFR 221.514(a)(1)(iii).

c. Projects involving eligible mortgagors to be insured under Section 221(d)(4) of the Act, the per family unit limits are found in 24 CFR 221.514(a)(1)(iii).

2. For elevator type structures:

a. Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3) of the Act, the per family unit limits are found in 24 CFR 221.514(b)(1).

b. Projects involving eligible mortgagors other than nonprofit mortgagors to be insured under Section 221(d)(3) of the Act, the per family unit limits are found in 24 CFR 221.514(b)(2).

c. Projects involving eligible mortgagors to be insured under Section 221(d)(4) of the Act, the per family unit limits are found in 24 CFR 221.514(b)(3).

Note: The correct per family unit limit must correspond to the SRO project unit type defined in paragraph 4-15.

3. Exceptions to insurable amount limitations:

a. The mortgage may exceed these limits by the percentage of the cost not attributable to dwelling use, including exterior land improvements.

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b. Per family unit limits may be increased by:
(1) The approved high cost percentage for the jurisdiction in which the project will be located.

(2) A percentage above the approved high cost percentage up to 140 percent maximum with the approval of the Commissioner on a case-by-case basis.

(3) No more than 90 percent if the mortgage has been, or is committed to be, purchased by GNMA in implementing its Special Assistance Functions under section 305 of the National Housing Act (as section 305 existed immediately before its repeal on November 30, 1983).

(4) If the Commissioner finds good cause in Alaska, Guam or Hawaii, the maximum, including high cost area increases may be increased by no more than one-half thereof.

2-14. AMOUNT OF LOAN - SUBSTANTIAL REHABILITATION. (Only projects involving substantial rehabilitation or reconstruction.) The loan must be the lesser of:

A. Amounts in paragraph 5-3, except B.

B. Applicable percentage of HUD's estimate of the cost of rehabilitation and fair market value of the land and existing improvements before rehabilitation, less the amount of grant/loan funds attributable to replacement cost items.

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2-15. OCCUPANCY PERCENTAGE. In HUD's multifamily mortgage insurance program for SRO's, the long term occupancy and rent collection ratio may not exceed 90 percent.