
 CHAPTER 10. THE MORTGAGE CREDIT PROCESS (ANALYSIS)

- 10-1. BASIC SOURCEBOOKS. Except as modified here, basic mortgage credit processing instructions are in HUD Handbook 4470.1, Mortgage Credit Analysis for Project Mortgage Insurance, Section 207, and HUD Handbook 4550.3, Investor-Sponsor and Nonprofit Sponsorship of Housing Cooperatives.
- 10-2. DETERMINING LOAN AMOUNT AND AMORTIZATION PERIOD. Analysis of the credit risk is based on a loan for a definite amount and amortization period.
- A. Mortgage will be a principal obligation stated in multiples of \$100.
 - B. Amortization period of the mortgage will be 75 percent of the estimated remaining economic life of the physical improvements or 40 years, whichever is less. For the initial curtail rates, approved term, and monthly payments, see HUD Handbook 4425.1, Application for Firm Commitment through Issuance of Firm Commitment for Project Mortgage Insurance.
 - C. Project offered for security must be designed principally for residential use and have at least five units.
- 10-3. AMOUNT OF LOAN - NEW CONSTRUCTION. Includes construction of all types of projects not involving rehabilitation. The insurable amount is the least of:
- A. Application Amount.
 - B. Applicable percentage of the lender's estimate of the replacement cost after completion, less the amount of grant/loan funds attributable to mortgageable items.

Section	Mortgagor	Percentage
(1) 221(d)(3)	General and Limited Distribution	90
(2) 221(d)(3)	Cooperative	98
(3) 221(d)(3)	All Others	100
(4) 221(d)(4)	All mortgagors	90

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- (10-3) C. Debt service that doesn't exceed the applicable percentage of project's estimated net income. The mortgage may

exceed this limit by capitalizing the savings from any tax abatement.

Section	Mortgagor	Percentage
(1) 221(d)(3)	General and Limited Distribution	90
(2) 221(d)(3)	All others (including cooperatives)	95
(3) 221(d)(4)	All Mortgagors	90

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.

\$21,563 per family unit without a bedroom

\$24,662 per family unit with one bedroom

\$29,984 per family unit with two bedrooms

\$38,379 per family unit with three bedrooms

\$42,756 per family unit with four or more bedrooms

- b) Projects involving eligible mortgagors other than nonprofit mortgagors to be insured under Section 221(d)(3) of the Act.

\$19,406 per family unit without a bedroom

\$22,195 per family unit with one bedroom

\$26,985 per family unit with two bedrooms

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\$34,541 per family unit with three bedrooms

\$38,480 per family unit With four or more bedrooms

- c) Projects involving eligible mortgagors to be insured under Section 221(d)(4) of the Act.

\$19,406 per family unit without a bedroom

\$22,028 per family unit With one bedroom

\$26,625 per family unit with two bedrooms
\$33,420 per family unit with three bedrooms
\$37,870 per family unit with four or more bedrooms

2) For elevator type structures:

- a) Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3) of the Act.

\$22,692 per family unit without a bedroom
\$26,012 per family unit with one bedroom
\$31,631 per family unit with two bedrooms
\$40,919 per family unit with three bedrooms
\$44,917 per family unit with four or more bedrooms

- b) Projects involving eligible mortgagors other than nonprofit mortgagors to be insured under Section 221(d)(3) of the Act.

\$20,422 per family unit without a bedroom
\$23,410 per family unit with one bedroom
\$28,467 per family unit with two bedrooms
\$36,827 per family unit with three bedrooms
\$40,425 per family unit with four or more bedrooms

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- c) Projects involving eligible mortgagors to be insured under Section 221(d)(4) of the Act.

\$20,962 per family unit without a bedroom
\$24,030 per family unit with one bedroom
\$29,220 per family unit with two bedrooms
\$37,800 per family unit with three bedrooms
\$41,494 per family unit with four or more bedrooms

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. (See paragraph 8-8c)

Section	Mortgagor	Percentage
1) 221(d)(3)	General and Limited Distribution	90
2) 221(d)(3)	Cooperatives	98
3) 221(d)(3)	All others	100
4) 221(d)(4)	All Mortgagors	90

- b) Per-family-unit limits may be increased by:

1. Seventy-five percent where local costs require it.
2. From 76 to 140 percent maximum, requiring case-by-case approval by the Commissioner.
3. No more than 90 percent if the mortgage has been, or is committed to be, purchased by GNMA.

(For current high-cost limitations, contact HUD Field Office with jurisdiction over the project.)

- c) The limits for walk-up and elevator structures may be increased up to 20 percent if necessary for purchase and installation of a qualified solar energy system. This is on top of any increase in a high-cost area.

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10-4 AMOUNT OF LOAN - REHABILITATION. (This includes only projects involving substantial rehabilitation or reconstruction.) The loan must be the lesser of:

- A. Amounts in paragraph 10-3, except for B.
- B. Applicable percentage of the lender's cost estimate of rehabilitation and fair market value of the land and existing improvements before rehabilitation, less the amount of grant/loan funds attributable to mortgageable items.
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Section	Mortgagor	Percentage
(1) 221(d)(3)	General and Limited Distribution	90
(2) 221(d)(3)	Cooperatives	98
(3) 221(d)(3)	All others	100
(4) 221(d)(4)	All Mortgagors	90

10-5. BUILDER-SELLER MORTGAGOR UNDER SECTION 221(d)(3)

- A. Before applying for project mortgage insurance, the mortgagor enters into an agreement (satisfactory to the lender) with a private nonprofit corporation eligible for insurance.
 - 1) The builder-seller mortgagor agrees to sell the project, on completion, to the nonprofit for no more than certified cost of the project.
 - 2) If the sale is not consummated, the project will be operated as a limited distribution rental project.
- B. Prepare two Forms HUD-92264A to determine the maximum insurable mortgage (MIM) for:
 - 1) Limited distribution mortgagor.
 - 2) Nonprofit mortgagor.
- C. Withhold the difference between the two MIMs developed above until the project is sold.

10-6. INVESTOR-SPONSOR MORTGAGOR UNDER SECTION 221(d)(3) certifies its intention to sell the project to a management type cooperative within 2 years after project completion.

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- (10-6) A. Prepare two Forms HUD-92264A to determine the MIM for:
- 1) Limited distribution mortgagor.
 - 2) Management type cooperative.
- B. Escrow the difference between the MIM amount available to the cooperative and the lesser amount available to the investor-sponsor.
- 1) Hold the escrow until the project is converted to a cooperative.

- 2) If the project is not converted to a cooperative within the required time, cut the mortgage by the amount of the escrow.

10-7. INSURING ADVANCES

- A. Initial/Interim Advances. Use basic Section 207 instructions except as modified here by paragraphs 10-5 and 10-6.
- B. Approval of a Final Advance for an investor-sponsor or builder-seller mortgagor may be conditioned on escrowing a portion of the mortgage proceeds until closing the sale to a cooperative (management type) or nonprofit mortgagor.

10-8. COST CERTIFICATION PROCEDURES. Use basic Section 207 instructions except as modified here.

- A. Certification purposes in builder-sponsor and investor-sponsor cases:
 - 1) To reduce the amount of the insurable mortgage.
 - 2) To establish the ceiling price at which the project may be sold.
- B. Legal, organization and marketing expense in investor-sponsor cases:
 - 1) Two legal and organizational expenses are involved in addition to marketing expense and should be shown separately in Form FHA 2330:
 - a) Expenses involving the mortgagor (investor-sponsor).

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- (10-8) b) Expenses involving the cooperative corporation formed to buy the project.
 - 2) Since the investor-sponsor is legally bound to use its best efforts to sell the project to a cooperative, its marketing expenses Should be included.
 - 3) If the legal and organizational sum attributable to the cooperative has been exhausted before final endorsement:
 - a) Investor-sponsor may deposit more money with the mortgagee before final endorsement for application against further organizational expenses of the cooperative (as approved by the lender).

- b) The additional deposits may be included in cost certification.

10-9. SUPPLEMENTAL COST CERTIFICATION

A. Adjustments for Undetermined Costs and/or Escrows

- 1) The law requires that the mortgage will not exceed the applicable percentage of actual costs.
- 2) The Agreement and Certification (Appendix 34) provides that where the Commissioner accepts, for cost certification, estimates of cost for any item the later substitution of certified actual costs may require a reduction of the mortgage amount.
- 3) Reductions of cost may arise from
 - a) Refunds, rebates, or discounts.
 - b) Excess of escrows over the actual costs of incomplete construction items.
 - c) Refund of amounts deposited by the mortgagor to save the mortgagee from loss in connection with sale of the mortgage (as set forth in Mortgagee's Certificate, or Request for Final Endorsement of Credit Instrument).

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- (10-9) d) Settlement of claims against bonding companies or others after project completion.

B. Supplemental Cost Certification Is No Longer Needed.
Instead the mortgagor must set up at final endorsement a cash escrow to pay all "to be paid in cash items" identified on Form FHA 2330, Mortgagor's Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid on Form FHA 2330.

- 1) Reconcile the difference between:
 - a) Obligations listed on the Request for Final Endorsement of Credit Instrument Form FHA 2023 or FHA 2455 (For Insurance Upon Completion Projects Only)
 - b) The "to be paid" column on Form FHA 2330 plus debts to third parties
- 2) Difference must be supported by paid receipts and a

statement from the mortgagor identifying by name and cost, those Items paid in cash. The receipts and statement are affixed to the Form FHA 2023/2455

- 3) Don't accept personal checks issued at final endorsement as evidence of payment.
- 4) Deduct obligations listed as "paid" or "to be paid" on Form FHA 2330 and which are represented at final endorsement as paid by FHA approved notes. Prepare a new Form FHA 2580 from the total of HUD approved cost on Form FHA 2331A.
- 5) Undisbursed mortgage proceeds may supplement or satisfy the cash escrow.
- 6) Use Form HUD-92464.1, Escrow Agreement for Unpaid Construction Costs.
 - a) To set up the cash escrow.
 - b) Attach a detailed listing of the unpaid costs.
- 7) Use Form HUD-92464, Request for Approval of Advances of Escrow Funds, to disburse escrow.

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- 8) Escrow should be disbursed within 45 days after final endorsement. If all of the funds are not disbursed follow the procedures in C below.
 - 9) At final endorsement, if all obligations have been paid in cash, nothing else is needed.

C. Sixty days after final endorsement:

- 1) Prepare a new Form FHA 2331A, Cost Certification Review Worksheet. Enter under the column heading:
 - a) "2264" - the amount of each item of cost recognized from the earlier Form FHA 2331A "Allowed" Column.
 - b) "2330/2330A" - the amounts listed in Column C of the Mortgagor's Certificate of Actual Cost, Form FHA 2330 for each item of cost.
 - c) "Allowed" - the amounts paid in cash based on the reconciliation performed in paragraph B above and disbursements from the cash escrow account.

- d) "Disallowed" - the lower of the amounts previously allowed or paid in cash.
- 2) Compute a New Maximum Insurable Mortgage, Form FHA 2580, or its equivalent based on the total of the "Disallowed Column", Form FHA 2331A above. If this computation produces an amount less than the mortgage amount finally endorsed:
 - a) Notify the Chief Underwriter and the Director of Housing Management by memorandum that prepayment to the mortgage is required.
 - b) Prepayment is mandatory and is applied:
 - 1. In amounts equal to the scheduled monthly principal payments, to the extent possible.
 - 2. Any remainder goes to the Reserve for Replacements Fund.

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 - c) If you are notified that payment has been delayed because of a dispute or litigation, retain funds to pay the amount pending resolution of the dispute.
 - d) Notify the escrow agent of the required payment.
 - e) Control the remaining balance in a special account, as a reserve for unpaid construction costs.
 - 3) Continue to use the existing amortization schedule for servicing the mortgage.
 - a) The prepayment is in addition to the regular monthly payments to principal.
 - b) There is no adjustment in the annual MIP due because of these mandatory prepayments to principal.
 - 4) The escrow requirement also applies to funds the general contractor owes.
- 10-10 Non-Section 8 Housing Projects Financed with 103(b) Industrial Revenue Bonds
- A. The lender may review financing documents associated with the tax-exempt mortgage bonds issued for non-Section 8 projects.
 - 1) The sponsor must submit, with the application for commitment

processing, a separate statement covering the estimated costs of issuance, discounts and financing fees to be paid out of pocket by the sponsor/mortgagor.

2) Mortgage Credit:

- a) Reviews the statement for reasonableness, using the data from previously processed 103(b) tax-exempt projects.
- b) Makes upward adjustments where appropriate.
- c) Uses this information to develop the Total Estimated Cash Requirements on the back of Form HUD-92264-A, Supplement to Project Analysis.

3) The construction loan and permanent loan rates may exceed the interest rate on the tax-exempt obligations. The spread between the two interest rates is controlled by the Treasury's arbitrage regulations.

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- a) You must explain the necessity of the spread; for example it may be used to pay the servicing fee on the obligations.
- b) The mortgagor should submit to you a copy of the written financial commitment from the bond underwriter to the issuer of the obligations.
 - 1. The commitment states the interest rate and conditions of purchase.
 - 2. If the commitment is unavailable, the issuer of the obligations must estimate the projected interest rate of the obligations. In such cases:
 - a. The firm commitment must contain the following condition:

"Any interest savings resulting purely from a differential between the HUD processed interest rate and the actual final interest may not be construed as excess funds that may be used to offset costs in other categories at the time of cost certification. Any such savings must be applied as a mortgage reduction."
 - b. An exception is that savings resulting from the early completion of construction may be used

to offset cost certifiable overruns in other cost categories. Compute interest savings by,

- 1 Recalculating the interest line item on Form HUD-92264, using of the actual interest rate for the scheduled construction period.
- 2 Subtracting the actual interest cost recognized at cost certification from the revised interest figure developed in 1 above.

B. Attached to and reflected in the Mortgagee's Certificate (Appendix 38) is an itemized statement of costs of issuance of the obligations, discounts, and financing fees paid through the coinsured lender.

- 1) The statement must explain why each individual item is necessary for the issuance of the obligations.

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- 2) Review the amount of each item to ensure its reasonableness in relation to comparable projects.
 - 3) Prepare a letter, for the Chief Underwriter's signature, informing the mortgagor that the lender will recognize for cost certification purposes:
 - a) The costs of issuance, discounts, and financing fees in an aggregate amount not to exceed the 3-1/2 percent included in the mortgage.
 - b) Exception may be made for additional charges if the sponsor/mortgagor could not benefit monetarily from excess investment income on the investment of the proceeds of the tax-exempt obligations.
 - 4) The lender, bond underwriter, and issuer have the option of deferring collection of additional discounts, financing fees, slow draw fees, etc., through provisions contained in of the Mortgagee's Certificate.
 - a) The deferred collection of these items must be an obligation of a third party and both the third party and the lender, bond underwriter or issuer must attest in writing that they will not look for payment from:
 1. Mortgagor.

2. Mortgaged property.
 3. Mortgagee proceeds.
 4. Any reserve or deposit required by the Commissioner and/or lender in connection with the mortgage transaction.
 5. Rents or other income from the mortgaged property.
- b) The mortgagor entity may issue as evidence of the debt a surplus cash or residual receipts note to the third party.
- C. Explain at the pre-cost certification conference that:
- 1) Mortgagor's accountant must detail in the notes to the financial statement:

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- a) Amount of interest paid on the tax-exempt obligations.
 - b) Source of the interest payments.
 1. Construction loan proceeds
 2. Monies advanced from the developer.
 3. Excess investment income.
 - c) Net amount of excess investment income.
 - d) Disposition of all escrowed funds, including any excess investment income, as specified in the trust indenture.
- For example:
1. Payment of HUD-insured project costs.
 2. Payment of interest on the bonds.
 3. Retirement of the bonds.
 4. Reimbursement of any remaining investment income to either the issuer of the tax-exempt obligations or the mortgagor entity.

- 2) Net excess investment income used to pay project costs will be treated as project income and used to reduce the total allowable costs after the calculation of BSPRA/SPRA.
- 3) Net effect of negative interest arbitrage (capitalized interest) maybe recognized if there are offsetting savings in the mortgage, provided that the:
 - a) Arrangements for collecting of capitalized interest were spelled out in the Mortgagee's Certificate, Form FHA 2434.
 - b) Developer could not benefit monetarily from possible excess investment income.
- 4) Any rebate to the sponsor/mortgagor from either the lender, issuer, or bond underwriter automatically reduces the mortgage at cost certification. The following are two samples of the most common types of rebates.

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- a) Mortgagee/bond underwriter contributes a portion of the initial service charge to pay discounts or other fees.
 - b) Mortgagee/bond underwriter refunds a portion of the construction loan interest to the mortgagor or sponsor.

10-11 OPERATING LOSS LOANS (Reserved)

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