CHAPTER 1. INTRODUCTION

1-1. PURPOSE. Section 311 of the Housing and Community Development Act of 1974 established a new Section 223(f) of the National Housing Act. Section 223(f) authorizes the Secretary to insure a mortgage executed in connection with the purchase or refinancing of an existing multifamily project. Enactment of this provision marks the first time in which FHA mortgage insurance is authorized for existing multifamily projects without a requirement for substantial rehabilitation. Infusion of new FHA-insured financing to existing rental projects, either to transfer ownership or refinance outstanding indebtedness, is intended to assist in the conservation of existing housing resources. In restating the National Housing Goal in the HCD Act of 1974, Congress found that national housing policies have not paid sufficient attention to preservation of existing housing and neighborhoods, and that the acceleration of housing decay and abandonment in recent years has partially offset progress made toward meeting national housing requirements. The 1974 Act calls for a greater effort at housing preservation, moderate rehabilitation, and improved management and maintenance. "Such an effort should concentrate, to a greater extent than it has in the past, on housing and neighborhoods where deterioration is evident but has not yet become acute" (Section 801, Title VIII). In implementing Section 223(f), HUD is choosing to establish essentially three separate approaches:

a. A Special Eligibility Program is applicable to recently completed projects which were started before June 30, 1974, and are completed before the end of 1975. The program recognizes the unusual circumstances currently prevailing in multifamily real estate financing. It is intended to provide construction lenders and builders a measure of liquidity, in connection with otherwise sound projects, and to help them work through the large volume of outstanding short term project financing on units which do not yet have adequate long term financing arranged. HUD wishes to make clear that, in assisting projects in these circumstances, it is incorporating procedures in the program for reviews and limitations aimed at protecting the Federal Government's financial interests, assuring that the program is actuarially sound, and above all assuring that failures are not permitted which could jeopardize the success of the longer term Section 223(f) program aimed at older properties.

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b. A General Eligibility Program is intended to provide financing in connection with properties three years old or older. This can achieve the same role in multifamily housing long played by FHA insurance in the existing home market. It provides access to financing for the large stock of existing structures. The sound preservation, ownership and transfer of these properties depends in good part on the availability of credit on reasonable terms. The program helps owners maintain properties in good condition by providing financing to cover costs of repairs and deferred maintenance, and may, by providing government insurance, reduce interest and amortization costs and thus reduce upward pressures on rents. The program also is expected to contribute to development of a national capital market for financing existing projects, thereby supporting the long term market for such housing through strengthening the confidence of owners in the liquidity of their investments. This program is expected to help conserve the national housing stock, and to do so on an actuarially sound basis, a course considered far preferable and far less costly than permitting disinvestment to take place and permitting excessive new construction.

c. Program for Refinancing Housing in Older, Declining Areas. In such areas, FHA financing is intended to help avoid deterioration, blight and abandonment, and to help stabilize or turn around neighborhoods where this process already has begun. As one of the sponsors of the Section 223(f) program stated:

> "Facilitation of refinancing in particular can be a major tool for 'moderate' housing rehabilitation and repair, because it will allow .... (owners) .... to obtain needed housing repair money without being forced to increase their monthly housing expenses. This can be done by stretching out an existing mortgage, so that the mortgagor pays the same amount or less per month but pays it over a longer period. FHA insurance for refinancing can also provide a means of financing 'balloon' payments, or lump sum payments due at the end of a mortgage term...." (Senator Taft: Congressional Record, February 19, 1975).

In accord with this intent, and to assure that the housing situation of low and moderate income families is recognized, the Act, with respect to refinancing in older, declining, areas, directs that: (1) the program should not be used to lower the

project owner's monthly debt service, except as necessary to assure the continued economic viability of the project, and (2) rent increases will be permitted only where necessary to offset actual increases in operating or other necessary costs. HUD expects this program to be used in connection with projects the economic viability of which can be reasonably assured. In some instances, the program may be suitable for use in conjunction with State and local programs for housing conservation, especially where they include plans for conservation on a neighborhood-wide or community-wide basis.

1-2. AUTHORITY. Section 223(f) of the National Housing Act as amended by the Housing and Community Development Act of 1974, Public Law, 93-383. Mortgage insurance will be provided only under Section 207. Applicable regulations for Section 207 appear in the Code of Federal Regulations, Title 24.

1-3. ELIGIBLE MORTGAGORS. The mortgagors may be either private or public, as defined in Section 207.17 of the Regulations.

1-4. ELIGIBLE PROPERTY. Property eligibility requirements are the same as for Section 207, except as modified herein.

a. Number of Living Units. The property offered for security must consist of not less than 8 living units, each of which must provide complete living facilities including provision for eating, cooking and sanitation within the unit.

b. Former Cooperatives or Condominiums. If the property was previously owned by a cooperative corporation or title was held by individuals under a condominium, the mortgagor must produce evidence satisfactory to the Secretary that all cooperative members or condominium owners have been paid in an amount that is no less than their investment, less any damage they may have inflicted on the property. The mortgagor shall also submit evidence that the necessary legal action has been taken to convert the project from cooperative or condominium ownership to a rental project.

c. Commercial Areas. Commercial areas shall not exceed 20 percent of the total net rentable area of the project and commercial income shall not exceed 25 percent of the estimated total gross project income.

(1-4) *d. Property Three Years Old. Three years (except for projects specially eligible to June 30, 1976, as provided in Paragraph 1-6) must have elapsed from the latter of the date of completion of the project or beginning of occupancy to date of application for mortgage insurance.

The date on which a certificate of occupancy, or equivalent used by the controlling local government, is issued for all units submitted for consideration is the date of initial occupancy. Project completion is the date on which the controlling local government issued the final inspection report for the entire property. *

e. The Remaining Economic Life, as estimated by the Secretary, must be long enough to permit at least a 10-year mortgage term.

f. Sustaining Occupancy. The project must attain sustaining occupancy (sufficient income to pay operating expenses, annual debt service and reserve fund for replacement requirements) prior to insurance endorsement or an operating deficit escrow must be provided in an amount sufficient to carry the project until sustaining occupancy is reached, (not to exceed 18 months).

g. Management Program Description. A description of the management program must be furnished when application for a conditional commitment, or a firm commitment if the conditional commitment stage has been by-passed, is submitted. The description should be brief and should address the relationship between the owner and the management agent, the proposed staffing of the project, and rent collection and maintenance procedures. A copy of the proposed lease shall also be submitted for approval. If the management agent has operating handbooks, they may be submitted instead of the above statement provided all of the above items are addressed. *

h. The Management Agreement shall be in conformity with the relevant sections of the "Suggested Housing Management Agreement" (Appendix 6, Handbook HM 4381.2) and shall be submitted when application is made for firm commitment. The proposed management fee shall be developed in accordance with Handbook 4381.5 and shall be submitted as a part of the Management Agreement. In those cases where an existing management agreement is in force, a copy of the agreement shall be submitted for review.

i. Substantial Rehabilitation Not Permitted. The property must meet general criteria for livability without the necessity of substantial rehabilitation. A property requires substantial rehabilitation if inspection reveals it to be substandard and

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(1-4) deteriorated, as defined below, or whenever the estimated cost of required repairs is more than 15 percent of the
* final estimate of value after repairs or $3,000 per unit, whichever is greater as determined by HUD. *

"Substandard or deteriorated properties are those which, while structurally sound, do not provide safe and adequate shelter; and in their present condition, endanger the health, safety, or well-being of the occupants. Such housing has one or more critical defects, or a combination of defects in sufficient number or extent to require considerable repair or rebuilding, or is of inadequate original construction. The defects are either so critical or so widespread that the structures should be extensively repaired. Such defects may include, but not be limited to: holes, open cracks, rotted, deteriorated, loose or missing material over a large area of the outside walls, roof, chimney, inside walls, floors, or ceilings; substantial sagging of floors, walls, or roof; extensive damage by storm, fire or flood, and inadequate or potentially hazardous utility systems and equipment; and a lack of hot and cold running water, a useable flush toilet, a tub or shower."

* j. Specific Replacement and Fire Safety Additions. The following specific items should be considered replacement and fire safety additions, as opposed to substantial rehabilitation and upgrading, and exempted from inclusion in the items subject to the 15 percent and $3,000 threshold:

(1) Replacement of:

(a) Ranges/Hood

(b) Ovens

(c) Refrigerators

(d) Garage disposals

(e) Dishwashers

(2) Purchase of fire safety equipment required by Federal, State or local law.

NOTE: Although the purchase costs of the items listed above would be exempted from the threshold, all installation costs are includable. *

* k. Elderly Housing Units. Units intended specifically for elderly occupancy must provide complete living facilities, including provisions for eating, cooking and sanitation within the unit.

1-5. MILITARY IMPACTED AREAS. Projects determined to be in military impacted areas will be subject to the processing procedures in reference (10) of the Foreword.