CHAPTER 7. PROJECTS IN OLDER, DECLINING URBAN AREAS

7-1. DETERMINATION OF OLDER, DECLINING URBAN AREAS. On all multifamily applications under Section 223(f) the Chief, Real Estate and Valuation/Chief Appraiser, shall determine whether the project is in an older, declining urban area. In making this determination, the following criteria shall be considered:

a. Population Density. The resident population density in the area and the proximity of the project to commercial and industrial buildings;

b. Age of Buildings. The age of residential and commercial buildings in the area;

c. Changes in Values. The changes in the past five years in value of properties in the area where the subject project is located in comparison to changes in value of properties in other parts of the city or community;

d. Percentage of Old Buildings. The location of the project in a neighborhood which is comprised predominantly (50% or more) of dwellings built prior to 1940; and

e. Excessive Decline. If the neighborhood where the project is located has declined to the extent that the appraiser would normally recommend insurance under Section 223(e), the project must be considered infeasible.

7-2. PROJECTS BEING SOLD. Where the mortgage is being obtained to finance a purchase and the project is located in an older, declining area, there is no change from the valuation principles and procedures and other standards contained in Chapters 1 through 6 of this Handbook.

7-3. PROJECTS BEING REFINANCED. Projects in an older, declining area which are being refinanced are subject to the valuation principles and procedures and other standards contained in Chapters 1-6 of this Handbook as well as the following additional provisions:

a. Lowering the Debt Service. Refinancing may not be used to lower the debt service except as necessary to assure the economic viability of the project. (See paragraph 7-4.)

b. Rental Increases. During the mortgage term, no rental increases shall be made except those which are necessary to offset actual and reasonable operating expense increases or other necessary expense increases approved by the Assistant Secretary for Housing Management. (See paragraph 7-5.)

7-4. LIMITATION ON LOWERING DEBT SERVICE. To prevent lowering the debt service an unreasonable amount in the case of refinancing transactions in older, declining urban areas, the mortgage credit examiner will take the following actions:

a. Maximum Mortgage Amount for Maximum Term. First, using the maximum mortgage term for subject project (limited to 35 years, or three-fourths of the estimated remaining economic life) the mortgage credit examiner determines the mortgage amount which may be insured in the refinancing transaction in accord with Chapter 6 of this Handbook.

b. Finding Debt Service As a Percentage of Net Income. The examiner computes the annual payment to debt service (interest, principal and MIP) for the maximum mortgage amount and term referred to in 7-4a above. This debt service is divided by the Annual Net Income to Project (from Line F-34 of Form 2264) to show debt service as a percentage of net income.

c. Reduction of Mortgage Term. If debt service is 65% of net income or a higher percentage, no further action is necessary; the mortgage amount and term referred to in paragraph 7-4a are used in the commitment. If debt service is less than 65% of net income at the term referred to in 7-4a, the mortgage term shall be reduced to such shorter term as will have a debt service equal to or slightly exceeding 65% of net income, and the larger debt service and shorter mortgage term shall be used in the commitment. The shorter term is determined as in the following example. Assume that a ten year old project to be refinanced is located in a declining urban area; and that processing reveals that net income is $11,000 and that the mortgage amount will be $68,000. The maximum mortgage term is 25 years, based on an estimated remaining economic life of 34 years. Debt service at 8-1/2% interest rate for 25 years on the $68,000 mortgage would be $6,910.65.

Test the need for a shorter term and determine the length of that term by the following steps:

(1) Determine 65% of the net income by multiplying $11,000 x .65 = $7,150. Compare the result, $7,150, with debt service on the mortgage ($68,000) for 25 years at 8-1/2% ($6,910.65). Since 65% of net income ($7,150) is larger than debt service at the maximum term ($6,910.65), this indicates a need for a shorter mortgage term.

(2) Determine the approximate debt service rate for this shorter term by dividing 65% of net income ($7,150) by the mortgage amount ($68,000).

$7,150/$68,000 = .105147 or 10.5147%

(3) Use the debt service tables in Exhibit 8 to find the mortgage term which has a debt service rate equal to, or slightly more than, the debt service rate derived from 65% of net income in step 2 (10.514%). The debt service rates at 8.5% interest for 24 years (10.29%) and 23 years (10.42%) are too small; but the debt service rate for 22 years (10.57% slightly exceeds the rate from step 2 (10.5147%). The reduced term is thus found to be 22 years. The reduced term of 22 years and its debt service are used in the firm commitment.

7-5. LIMITATION OF RENTAL INCREASES. For projects being refinanced in an older, declining urban area, rent increases during the mortgage term shall be limited to those necessary to offset operating expense increases, or other necessary expense increases approved by the Assistant Secretary for Housing Management. This is done by omitting the override of .5% from Lines 6a and 6b of the Rent Formula For Existing Rental Housing Under Section 223(f). As time passes, increases may be made in Line 14 of the Rent Formula, only in amounts commensurate with the increase in total annual expense and ground rent applicable to living units, shown in Line 8 of the Rent Formula. If the term of the mortgage is reduced under the provisions of paragraph 7-4 above, the Rent Formula must be recomputed, using the debt service rate applicable to the reduced mortgage term (without the over-ride) in Line 6a of the Rent Formula.