CHAPTER 3. PROGRAM REQUIREMENTS

3-1. ELIGIBLE PROPERTY. The property offered as security must consist of not less than five living units, each of which must provide complete living facilities including provision for eating, cooking and sanitation within the unit.

a. Former cooperatives or condominiums. If the property was previously owned by a cooperative corporation or title was held by various parties under a condominium, the mortgagor must produce satisfactory evidence that the consent of all such parties has been obtained prior to conversion of the project to a rental basis. The new 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. Condominiums are not eligible mortgagors under the 223(f) coinsurance program. At this time, a policy has not been developed concerning the eligibility of cooperatives under the program. When such a policy is finalized, this handbook will be amended appropriately.

b. Mobile home parks and courts are not eligible under the 223(f) coinsurance program.

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 projected total gross project income. The acceptability of the commercial usage must be determined by the lender on the basis of suitability, market, current leases, etc.

d. Property three years old. Three years must have elapsed from the later of: (1) the date of completion of construction or substantial rehabilitation of the project, i.e., the date on which the controlling local government issued the final inspection report for the entire property, or (2) the date of initial occupancy to the date of application for a 223(f) coinsured mortgage, i.e., the date on which a certificate of occupancy, or equivalent used by the controlling local government, is issued for all units submitted for consideration.

e. Condition of the property. The property, in its present condition, must meet general criteria for livability without the necessity of substantial rehabilitation in order to be eligible for consideration under the Section 223(f) coinsurance

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(3-1) program. A property requires substantial rehabilitation if inspection reveals it to be substandard and deteriorated, or whenever the estimated cost of required repairs is more than 15 percent of the final estimate of value of the project after repairs or $6,500 plus the applicable high cost factor per unit, whichever is greater, as determined by the coinsurance lender provided that not more than one major building component (i.e., roof structure, ceiling, wall, floor structure, foundation, elevator, plumbing, heating, air conditioning, or electrical system) is being replaced.

Substandard or deteriorated properties are defined as those which, while structurally sound, do not in their present condition provide safe and adequate shelter, and/or 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, and either a tub or shower.

f. Properties held in a coinsurance lender's portfolio (or that of a subsidiary, parent, etc.) may be refinanced under the 223(f) coinsurance program provided that (1) the loan is current in its payments and has not been in default, modification, or forebearance at any time during a continuous period of at least 2 years preceding the date of coinsurance application; (2) such loans are submitted to HUD Headquarters for review prior to the lender's commitment to coinsure; (3) such portfolio loans do not exceed one-fourth of the total number of loans coinsured under this program by that lender in any period of 12 consecutive months. Excepted from the one-in-four provision are loans in the lender's, subsidiary's or parent's portfolio which are presently HUD-insured and are being refinanced for existing owners. In such cases, requirements (1) and (2) above still apply and, in addition, the amount of the coinsured mortgage loan cannot exceed the original amount of the fully-insured mortgage loan.

(3-1) All coinsured loans to be made in connection with properties in which the lender, subsidiary, parent, or principals thereof has or will have an ownership interest require HUD review prior to the lender's commitment.

g. Flood insurance. No federal assistance shall be approved for acquisition, construction, reconstruction, repair, or improvement of a building located in an area that has been identified by the Federal Emergency Management Agency (FEMA) as having special flood hazards unless the community in which the area is situated is participating in the National Flood Insurance Program and the regulations thereunder (44 CFR Parts 59-79) or leas than a year has passed since FEMA notification regarding such hazards, and flood insurance on the structure is obtained in compliance with Section 102(a) of the Flood Disaster Protection Act of 1973 (Public Law 93-234, 42 U.S.C. 4001 et seq.). The lender is solely responsible to determine that these restrictions are met.

h. Historical site determination. The lender must determine if the project is subject to historical requirements and, if so, make certain that such requirements are fully satisfied prior to loan closing. This determination can be made by contacting the local Historical Society. A certification, signed by an authorized official of the lender, must be placed in the project file to the effect that the project is not subject to historic requirements or that all such requirements have been satisfied.

3-2. RELATED PROGRAM REQUIREMENTS:

a. Rental rates. Project owners may not charge a gross rental in excess of that determined by the lender as necessary to pay a fee for adequate management and to meet all expenses, reserve funding, mortgage obligations and provide a reasonable profit. Where a property is subject to rent control, the rents must not exceed those permitted by the rent control provisions. Dividends may be paid from surplus cash in accordance with the instructions in Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects, and the Regulatory Agreement utilized for the 223(f) coinsurance program (see Appendix 33).

b. Remaining economic life. The remaining economic life of the project, as estimated by the lender, must be sufficient to support the requested mortgage term as set forth in subparagraph c below.

(3-2) c. Mortgage term. The term of the mortgage shall not be less than 10 years, nor shall it exceed the lesser of 35 years or 75 percent of the estimated remaining economic life of the physical improvements. The maximum term may be increased to the lesser of 40 years or 100 percent of remaining economic life if the project meets the requirements of 207.32a(1).

d. Military impacted areas. Particular attention must be given the market analysis of projects which are the subject of applications for coinsurance in locations where housing demand generated by military, atomic energy or space installations is of a sufficient magnitude to substantially affect the housing market for that area. Projects which are located within such areas require special consideration. Therefore, such analyses must be submitted to HUD Headquarters, Office of Multifamily Housing Development, with the lender's recommendation for approval on a case-by-case basis.

e. Selection of occupants. All families and individuals subject to normal tenant selection are eligible for occupancy. There is no restriction by virtue of the tenant's income. The mortgagor must:

(1) Refrain from utilizing criteria or methods of selecting tenants which discriminate against any family by reason of the fact that there are children in the family, unless the project was designed specifically for occupancy by elderly people; or discriminate against any family by reason of the sex of the household head.

(2) Comply with the provisions of Title VIII of the Civil Rights Act of 1968 as amended and regulations issued pursuant thereto, which prohibits discrimination because of race, color, religion, sex, or national origin, and administer the program and related activities in a manner to affirmatively further fair housing. The applicant shall also comply with similar State and local fair housing laws and ordinances.

(3) Comply with the provisions of Executive Order 11063 on Equal Opportunity in Housing which deals with preventing discrimination on the basis of race, color, religion (creed) or national origin in housing and related facilities provided through Federal financial assistance and all regulations issued pursuant thereto.

(3-2) (4) Not discriminate on the basis of race, color, creed, sex or national origin against any employee or applicant for employment, to include a provision to this effect in any contract or subcontract executed for project repairs and improvements, and to comply with the provisions of Executive Order 11246, when applicable to such contracts.

(5) There may not be any leases executed for a period of less than thirty days or for transient rentals, nor can the mortgagor provide occupants with the customary hotel services such as room service for food and beverages, maid services, furnishing and laundering of linens and bellhop services.

f. Sustaining occupancy. The project must attain sustaining occupancy (sufficient income to pay operating expenses, annual debt service, mortgage insurance premiums, and reserve fund for replacement requirements) prior to insurance endorsement or an operating deficit escrow must be provided and maintained by the lender in an amount sufficient to carry the project until sustaining occupancy is likely to be reached (not to exceed 12 months). If an operating deficit is projected to exceed 12 months from the date of endorsement, the project is not acceptable for coinsurance.

Lenders are cautioned that an operating deficit is not to be established where an artificially increased mortgage amount would result; for example, where projected short-term increases in rent levels (necessary to support a given mortgage amount) cannot be supported by thoughtful market analysis.

g. Older declining areas. In the case of refinancing, if the property is located in an older, declining urban area, the refinancing may not be used to lower the monthly debt service except as necessary to assure the economic viability of the project.

(1) In determining whether a project is located in an older, declining area, some of the considerations the lender must take into account are (a) the location of the project in a neighborhood comprised predominantly of dwellings built prior to 1940; (b) trends in property value in the past five years in the area in which the project is located compared to those in other parts of the community; (c) the resident population density;

(3-2) (d) the proximity of the project to industrial or heavy commercial structures. If the area is such that it would qualify for FHA insurance under Section 223(e), the project must be considered ineligible for the Section 223(f) coinsurance program.

(2) A format for computing the term for projects located in these areas is shown at Appendix 1.

(3) The lender's processing file must contain documentation concerning its determination that the project is or is not in an older, declining area.

(4) Note that all projects meeting the requirements of 207.32A(1) are considered as being in older, declining areas.

h. If the coinsured mortgage involves the purchase or refinancing of a project which has a Section 8 New Construction or Substantial Rehabilitation HAP Contract or other rental assistance agreement in force, special rental limitations apply. In such instances, the lender must contact the HUD Office of Housing Management, HUD Headquarters, on a case-by-case basis for a determination of applicable limitations.

i. Waivers. Lenders are required to comply with the instructions and guidance provided in this handbook. It is recognized, however, that circumstances may arise where a waiver of some provision may be justified. In such cases, lenders may request a waiver in writing to the Office of Multifamily Housing Development, HUD Headquarters, giving full particulars, documentation, etc., in support of such request.

3-3. REINSURANCE. The lender may obtain insurance on an individual mortgage basis from a duly licensed mortgage guarantee insurer in an amount equal to (1) 50 percent of its coinsurance risk in connection with that particular mortgage; (2) 100 percent of such risk; or (3) that percentage of such coinsurance risk which equals the maximum amount which the mortgage guarantee insurer is authorized to reinsure.

For purposes of this program, a licensed mortgage guaranty insurer may include any licensed surety or insurer authorized by the state or federal licensing jurisdiction to insure the mortgage risk the lender undertakes under this program.

3-4. DISPLACEMENT. It is HUD's policy to minimize the displacement of tenants in implementing its programs. In the 223(f) coinsurance program, the coinsurance lender is responsible for effectively implementing this policy. Therefore, if it is contemplated that the repair program to be accomplished in connection with the transaction will cause involuntary displacement of tenants, the mortgagor must provide, as a part of its application, a plan to minimize the effects of such displacement. The lender must determine that the plan is adequate and that the mortgagor is financially and physically capable of carrying out its plan in this regard.