

U.S. Department of Housing and Urban Development

H O U S I N G

Special Attention of:

Regional Administrators Transmittal for Handbook No.: 4567.1
Regional Housing Directors
Managers and Directors of Issued: 4/7/93
Housing Development and Housing Management
Chiefs, Housing Programs, Valuation,
Mortgage Credit, Architecture, Engineering
and Cost, and Loan Management

1. This Transmits:

New HUD Handbook 4567.1, Refinancing of Insured Multifamily
Projects Pursuant to Section 223(a)(7).

2. This handbook updates policies and procedures for processing
Section 223(a)(7) refinancings of HUD-insured multifamily
projects, including formerly coinsured projects that are now
fully insured and not HUD-held. It includes instructions
for transactions that are purely financial as well as for
those that include repairs to the project. In many cases,
the instructions in this Handbook are based on similar
procedures used in the Section 223(f) program.

3. Filing instructions:

This handbook supersedes the portion of Handbook 4260.1
dated 1972 relative to refinancing of multifamily insured
mortgages under Section 223(a)(7).

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Handbook 4567.1

U.S. Department of Housing and Urban Development
Office of Housing

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and Program

Participants

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Refinancing of
Insured Multifamily
Projects Pursuant to
Section 223(a)(7)

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FOREWORD

This handbook contains the policies and procedures for processing refinance transactions pursuant to Section 223(a)(7) of the National Housing Act. These instructions apply to multifamily insured projects (except for hospital projects) in HUD's portfolio that are not HUD-held.

References:

- (1) 4430.1 REV-1 Initial Closing Commitment for Project Mortgage Insurance
- (2) 4440.1 Final Closing Commitment for Project Mortgage Insurance
- (3) 4450.1 REV-1 Cost Estimation for Project Mortgage Insurance
- (4) 4460.1 REV-1 Architectural Analysis and Inspections for Project Mortgage Insurance
- (5) 4465.1 Valuation Analysis for Project Mortgage Insurance
- (6) 4470.1 REV-2 Mortgage Credit Analysis for Project Mortgage Insurance
- (7) 4480.1 Multifamily Underwriting Reports and Forms Catalog
- (8) 4565.1 Mortgage Insurance for the Purchase or Refinancing of Existing Multifamily Housing Projects - Section 223(f)
- (9) 4600.1 REV-1 Section 232 Mortgage Insurance for Residential Care Facilities (Nursing Homes, Intermediate Care Facilities and Board and Care Homes)

CHAPTER 1. INTRODUCTION

- 1-1. PURPOSE. Section 223(a)(7) of the National Housing Act (NHA) permits refinancing of HUD-insured multifamily projects. Refinancing under section 223(a)(7) results in prepayment of the existing mortgage, endorsement of a new, refinanced mortgage and a new project number. Such refinancing may entail certain required improvements and/or a new mortgagee. This Handbook supersedes the instructions of Handbook 4260.1, dated 1972 relative to refinancing of insured multifamily mortgages under Section 223(a)(7).
- 1-2. BACKGROUND. Many mortgagors have expressed interest in refinancing existing multifamily insured mortgages, particularly those insured when interest rates were high. Refinancing of existing multifamily insured mortgages is permitted under each Section of the NHA pursuant to Section 223(a)(7) of the Act. Regulations are contained under each applicable Section (e.g., 24 CFR Section 221.560). Such refinancings strengthen HUD's security by reducing debt service loads and permitting minor repairs to projects already in the Department's portfolio of insured loans.

If the proposal is solely for a reduction in interest rate, as agreed between the mortgagor and mortgagee, it may be handled by a modification of the mortgage documents rather than using Section 223(a)(7). Modifications may be approved by the Field Office Manager and must take into account any Housing Management requirements relative to reduction in subsidized rents.

Section 223(a)(7) refinancing may involve only a financial transaction - refinancing of the mortgage and loan closing - or may involve repairs or improvements to the project. When the latter is the case, procedures relative to environmental review, completion of repairs, cost certification and the like are based on similar procedures in the Section 223(f) program. Because it is in the Department's interest for projects to be refinanced under Section 223(a)(7) and only insured portfolio projects that are not HUD-held are eligible, the procedures have been kept to a minimum. It is hoped that they are flexible enough to allow minimal processing for solely financial transactions and reduced processing for repair cases.

CHAPTER 2. BASIC PROGRAM REQUIREMENTS

- 2-1. ELIGIBLE PROJECTS. This handbook applies to the refinancing of full insurance mortgages, except for hospital projects insured under Section 242 or section 241 supplemental loans for hospital projects, and may not be used in conjunction with coinsured mortgages. Mortgages that were previously coinsured but converted to full insurance and are not HUD-held may be refinanced under these procedures.
- 2-2. MAXIMUM MORTGAGE. The requested mortgage amount may not exceed the lowest of the following:
- A. Ninety percent of the value of the project after completion of repairs, improvements or additions under all Sections of the Act, except Section 223(f) which is limited to 85 percent. For projects involving grants or loans, deduct these grant or loan funds attributable to mortgageable items from the value of the project after completion of repairs or improvements. Multiply this result by 90 percent (or 85 percent), as above.
 - B. The original principal amount of the existing insured mortgage amount.
 - C. The unpaid principal balance of the existing insured mortgage amount plus:
 - 1. cost of required improvements;
 - 2. outstanding debt incurred in connection with capital improvements made to the property that are acceptable to the Field Office; and
 - 3. loan closing charges, including the application fee, inspection fee, financing fee, prepayment penalties, and title and recording and legal fee and required deposits to the reserve for replacements. The cost of defeasance of any existing bond issue may not be included.

The above calculations must be reduced by the amount of any grant or loan funds attributable to mortgageable items.

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- (2-2) D. The amount that can be amortized by 90 percent of net operating income irrespective of mortgagor type (85 percent for Section 223(f) projects).

For cases where the original HUD-insured mortgage will remain intact and a HUD-insured second mortgage will be refinanced under Section 223(a)(7), multiply the net operating income by 90 percent and reduce this result by the annual debt service requirements for the original mortgage. The amount resulting from this computation is available to amortize the Section 223(a)(7) mortgage.

- 2-3. ENVIRONMENTAL REVIEW REQUIREMENTS. There are no environmental review requirements for solely financial transactions. However, for applications proposing any repairs, a limited environmental review and preparation of Form HUD-4128.1 (Compliance and LAC Conditions Record) are required similar to the procedures for Section 223(f) projects.
- 2-4. MORTGAGE TERM. The term of the new mortgage may not exceed the remaining term of the existing mortgage. However, the term may be up to 12 years beyond the term of the existing mortgage if required for project feasibility. The Director of Housing Development, in consultation with the Director of Housing Management, must determine that the longer term is necessary (i.e., without the additional term, the rents will not support the project's expenses) and that the new term does not exceed 75 percent of the project's remaining economic life.
- 2-5. PROCESSING FEE. A fee of \$3.00 per \$1,000 of requested mortgage amount must accompany an application for Section 223(a)(7) mortgage insurance.
- 2-6. MAXIMUM FEES. Financing fees are no longer limited to 1.5 percent. Present day costs and methods associated with the financing and refinancing of mortgages are more complex and varied than when Handbook 4260.1 governing Section 223(a)(7) was originally issued (e.g., discounts, tax-exempt bond financing). Maximum financing fees in Section 223(a)(7) are limited the same as with a refinancing transaction in Section 223(f) - i.e., 3.5 percent which may be included in replacement cost. Total fees in a bond transaction are capped at 5.5 percent. The specific requirements relative to fees are in Handbook 4470.1 REV-2, Mortgage Credit Analysis.

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- 2-7. INSPECTION FEE. If repairs are proposed, collect an inspection fee of \$30 per unit where the cost of repairs is \$3,000 or less per dwelling unit. Collect a fee of 1 percent of the cost of repairs when repair costs are higher than \$3,000 per unit.
- 2-8. PREVAILING WAGE REQUIREMENTS do not apply unless the required repairs meet the definition of substantial rehabilitation (24 CFR Section 207.24(c)). It is not anticipated that this level of repairs will be reached in most Section 223(a)(7) projects.
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CHAPTER 3. APPLICATION SUBMISSION REQUIREMENTS

- 3-1. SUBMISSION OF APPLICATION. An application with fee must be submitted by a HUD-approved mortgagee to the HUD Field Office with jurisdiction. A Section 223(a)(7) application is for the Firm Commitment stage only.
- 3-2. REQUIRED EXHIBITS.
- A. Signed application form for mortgage insurance (Forms HUD-92013, 92013NHICF, or 93201, as appropriate). The only exhibits listed on the back of Form HUD-92013 that are required for a Section 223(a)(7) application are those included in this section.
 - B. Form HUD-92013-SUP for the mortgagor entity.
 - C. Verification of the existing insured mortgage and verification of any other secured or unsecured debt of the mortgagor, including references to any prepayment penalties.
 - D. Verification of escrow balances.
 - E. Current rent roll.
 - F. Credit reports on the mortgagor entity.
 - G. Audited project financial statements for the last 3 years or since occupancy, whichever is less, if not available at Field Office (Loan Management). In all cases, if the latest audit is more than 3 months old, it must be supplemented by an owner-certified year-to-date balance sheet and operating statement with the criminal certification found on the reverse of Form HUD-92417.
 - H. Description and estimate of required repairs, if any.

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- (3-2) I. If new partners are proposed, a Form HUD-2530 for each new covered principal as required in Handbook 4065.1. Changes in ownership are subject to Handbook 4350.1, Insured Project Servicing Handbook, relative to Transfer of Physical Assets.

- J. Byrd Amendment (lobbying) disclosure forms.
- K. For projects built prior to 1978 (except for elderly projects and residential care facilities under Section 232), lead-based paint test report and certification if lead-based paint was previously abated.
- L. If repairs are proposed, Form HUD-92010 on equal employment opportunity.

CHAPTER 4. APPLICATION PROCESSING

- 4-1. OVERVIEW. The purpose of processing under Section 223(a)(7) is not to reunderwrite the project as if it were a new project. These mortgages to be refinanced are already in HUD's insured portfolio and the goal is to improve their financial and physical condition and, therefore, HUD's security. The level of review will be dictated by the specifics of each case. For example, if a portion of the repair and closing costs cannot be fully covered by mortgage proceeds, evidence of financial capacity would be required. On the other hand, straightforward financial transactions should be processed with the fewest steps possible.
- 4-2. PROJECT NUMBERING. Projects should be numbered with the next number under the same Section of the Act under which the project was originally insured. Production method should be input as Code 6 (223(a)(7)) in the MIPS database. Previously coinsured projects (number series 94000) should be numbered in a similar manner (e.g., the next Section 221(d) number if the project was originally a Section 221(d) project). However, it is important that HUD be able to track what has happened to the coinsurance portfolio. Therefore, it is essential that the superseded 94000 number be maintained in the MIPS database.
- 4-3. TECHNICAL PROCESSING. Process a refinancing transaction as follows:
- A. Architectural, Engineering and Cost staff must inspect the project to determine that the project is in satisfactory condition and has been properly maintained. Requirements may be made on the commitment concerning necessary repairs and improvements. The repair list should specify critical and noncritical repairs (if any). Noncritical repairs may be completed after endorsement in accordance with Chapter 6. Lead-based paint requirements and testing and abatement (which are eligible costs) are covered in Handbook 4460.1 REV-1, paragraph 1-40. The scope of repairs must also be reviewed by Loan Management. Cost staff must prepare an "as new" replacement cost and a supplemental cost estimate for any required repairs. See instructions in Handbook 4565.1 for Section 223(f) projects.

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- (4-3) B. Valuation staff must determine the project's value in order to ensure that the 90 percent of value criterion is not exceeded (see paragraph 2-2A). Use the procedures in Handbook 4565.1 for Section 223(f) projects.
- C. Mortgage Credit must determine that the income is sufficient to meet all expenses and the debt service of the new mortgage. Mortgage Credit must also analyze the existing debt to determine its acceptability for inclusion in the refinanced mortgage. Unsecured debt will not be considered unless it is reflected in the audited financial statements.
- D. Loan Management (LM) will provide the Director of Housing Development recommendations addressing housing management concerns as follows:
1. LM must review the operating expenses, income, occupancy levels, existing debt, and proposed repairs for acceptability. LM will also review the adequacy of the reserves, including the reserve for replacements, and advise on any required additional payments to the reserves to be made as a condition of the commitment.

For the replacement reserve, this is generally a minimum of 2 years' need. Funds must be provided at closing if there is less than 2 years' need in the reserve for replacements and insufficient mortgage proceeds at closing to fund the reserve at an adequate level. The need to increase the monthly deposit to bring the reserve to an adequate level will also be addressed by LM.
 2. LM must determine before commitment that any audit findings or deficiencies have been resolved.
 3. If a project is receiving rent subsidies, and if refinancing will result in a reduction of debt service payments, the amount of rent subsidy must be recalculated. Section 142 of the Housing and Community Development Act of 1987 required such recalculation for Section 8 projects that are refinanced in a manner that reduces periodic payments to the owner.

(4-3) (D3) When financing lowers the debt service, the Section 8 Contract rents should be reduced for assisted units in accordance with Office of Housing Management procedures. However, LM may permit owners to retain a portion of the savings not to exceed 10 percent of the Section 8 savings as an incentive to refinance. In addition, State and local tax-exempt bond issuers are permitted by the McKinney Act to keep a higher level of savings (up to 50 percent).

CHAPTER 5. COMMITMENT AND CLOSING

5-1. COMMITMENT.

- A. The commitment should be in letter form listing the commitment amount, terms and requirements, including any required repairs (critical/noncritical) and a requirement for a new Regulatory Agreement. The commitment should also require that the owner must notify the Architectural, Engineering and Cost Branch when any noncritical repairs deferred until after endorsement are underway.
- B. The commitment is valid for a period of 90 days. It is not anticipated that extensions will be necessary in Section 223(a)(7) refinancing. However, the Field Office may extend Section 223(a)(7) commitments for a maximum of three additional 30-day periods, provided that processing and underwriting conclusions are current at the time of any extension.
- C. The commitment must require that the existing Reserve for Replacements will be transferred in total with the new mortgage and that the payments to the Fund will continue to be paid. In addition, any deficiency in the Fund as well as any other reserve deficiencies resulting from deferments of payment or other documented cause must be addressed based on the recommendation of Loan Management (see paragraph 4-3D).

5-2. REGULATORY AGREEMENT. A new Regulatory Agreement must be executed at closing under the same Section of the Act as the original loan.

5-3. CLOSING. Projects will be closed using standard closing procedures (see Handbooks 4430.1 REV-1, 4440.1 and applicable program handbooks). The amount of Mortgage Insurance Premium required at closing follows the provisions of the program under which the mortgage is being reinsured.

5-4. BEGINNING OF AMORTIZATION. Amortization shall begin on the first day of the second month following the date of the initial/final endorsement of the mortgage.

CHAPTER 6. PROJECTS WITH REPAIRS

6-1. CRITICAL AND NONCRITICAL REPAIRS. Critical repairs must be completed, inspected and approved by the Field Office before endorsement. However, noncritical repairs may be deferred until after endorsement in accordance with the procedures in this chapter. Noncritical repairs are those that will not:

- endanger the safety and well-being of tenants, visitors and passersby,
- adversely affect ingress or egress, or
- prevent the project from reaching sustaining occupancy.

6-2. REPAIR ESCROW. When repairs are proposed that will be completed using mortgage proceeds after endorsement, a repair escrow must be established similar to that used in the Section 223(f) program. Repairs must begin immediately after endorsement and be completed within 12 months.

6-3. ESCROW AGREEMENT (Form FHA-2476-A).

- A. The mortgagor must establish an escrow with the mortgagee equal to at least 150 percent of the estimated cost of the repairs to be completed after endorsement. The escrow shall be funded as follows:
1. Costs of the deferred repairs (including materials, labor, permits, profits, etc., trended to the start of repairs) must be estimated and withheld in cash from mortgage proceeds and placed in escrow. A letter of credit may not be substituted for this 100 percent escrow.
 2. An additional cash amount (or letter of credit, at option of the mortgagee) of not less than 50 percent of the repair cost estimate will also be placed in escrow.

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- (6-3) B. The mortgagee may release funds from the escrow as work is completed, releasing funds first from the mortgage proceeds portion of the escrow.

- C. Funds remaining in the escrow account, including the 50 percent portion provided by cash or letter of credit, may be released when: (1) all repairs have been satisfactorily completed, (2) a supplemental cost certification (see paragraph 6-5) has been approved by the Field Office; and (3) latent defects assurances have been provided (if required; see paragraph D. below).

The supplemental cost certification must indicate that there are no further amounts owed by the mortgagor in connection with the repairs. The updated title search must indicate that no liens have been placed on the project as a result of the repairs.

- D. Latent defects assurances are not required where the repairs relate only to deferred maintenance items and minor cosmetic repairs such as painting. When repairs and replacements are more significant, see latent defects requirements in paragraph 6-4C below.

6-4. COMPLETION OF DEFERRED REPAIRS.

- A. All deferred repairs must be completed by the mortgagor within 12 months of endorsement (or such shorter period as HUD and the mortgagee may specify).
- B. If the mortgagor has not completed all repairs by the end of the repair period (including any extensions approved by the Director of the Housing Development Division), the mortgagee will complete the repairs using the escrowed funds. The mortgagee will provide the mortgagor with a breakdown of these repairs and the cost(s) of completion (including administrative expenses). The mortgagor will use this breakdown in preparing the supplemental cost certification required by paragraph 6-5 below. Funds remaining in the escrow account after completion and after the supplemental cost certification has been approved by the Field Office will be returned to the mortgagor less reasonable administrative costs incurred in completing the repairs.

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- (6-4) C. When required, assurance against latent defects for 1 year from completion of repairs must be provided by one of the following:

1. An escrow in cash, or letter of credit at the option of the mortgagee, equal to 2-1/2 percent (or greater percentage as warranted) of the repair cost maintained for 15 months from completion of repairs to cover situations where the defect is discovered in the twelfth month and additional time is necessary to correct it.
2. A Surety Bond covered by Form FHA-3259 from a surety on the accredited list of the U. S. Treasury for at least 10 percent of the repair cost. (The Bond runs for a period of 2 years from the date of completion of repairs.)

6-5. REQUIREMENTS AFTER COMPLETION OF DEFERRED REPAIRS.

- A. The mortgagor must submit a supplemental cost certification of the actual costs of the deferred repairs.
- B. In cases where actual costs are less than estimated, the maximum insurable loan amount must be recalculated. If the maximum insurable mortgage is reduced due to lower actual costs, the mortgagor must prepay the mortgage in one of two ways:
 1. Remit the required prepayment, or
 2. Have the required prepayment amount deducted from the balance of the repair escrow.

6-6. INSPECTIONS. Inspections for repair cases may be performed by HUD Architectural and Engineering staff or under contract. Although the Technical Disciplines Contracts do not specifically reference Section 223(a)(7), the Statement of Work has procedures for "special inspections," including Section 223(f) and guarantee inspections. The procedures are based on a single fixed price per inspection for all such inspections. Section 223(a)(7) repair inspections are identical to those done under Section 223(f) projects or for guarantee inspections.

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- (6-6) A. If repairs will be completed before endorsement, use the instructions in Chapter 3 of Handbook 4565.1 for inspections under the Section 223(f) program.
 - B. When the Field Office has permitted the project owner to defer noncritical repairs until after endorsement,

the owner will notify the Architectural, Engineering, and Cost (A&E) Branch Chief when repairs are underway in accordance with Firm Commitment requirements. While Section 223(a)(7) are likely to require only a final inspection of the work, interim inspections may be made where A&E finds such inspections warranted.

- 6-7. COST CERTIFICATION. Since the level of repairs is expected to be limited, use the simplified cost certification procedures for Section 223(f) in Handbook 4565.1 when the transaction includes repair work.