CHAPTER 4. MORTGAGE CREDIT ANALYSIS

4-1. MORTGAGE FINANCING. The sponsor is responsible for locating source for the required mortgage funds. It is important that tentative arrangements for financing be made during the early development do the proposal in order to avoid the unnecessary expenditure of time, effort and money in the event mortgage funds are are not available.

a. Source of Funds. Although HUD-FHA may not recommend a specific source of mortgage funds, its Field Offices may assist sponsors to the extent of providing lists of HUD-FHA approved mortgagees (lenders) in the area who make loans of the type and amount desired. In the nation, there are approximately 24,000 financial institutions, including branch offices, approved by HUD-FHA for the insurance of loans under its various programs. These approved lenders include national banks, state banks, mortgage companies, insurance companies, savings and loan associations, and savings banks.

b. Formal Application. Although the sponsor may deal directly with the HUD Field Office in the preapplication project analysis stage, formal application by the sponsor for mortgage insurance must be submitted through, and joined in by, the HUD-FHA approved mortgagee who agrees to make the mortgage loan.

c. Legal Requirements. The law requires the sponsor to demonstrate, to the satisfaction of HUD, that it has made a bona fide unsuccessful effort to obtain conventional mortgage financing on terms comparable to those available under a HUD-FHA insured loan. Evidence of such effort will be presented at the time the Application for Mortgage Insurance is filed with HUD-FHA. The evidence must be in the form of letters from three lending institutions indicating that they were unwilling or unable to provide the sponsor with conventional financing comparable to HUD-FHA financing.

4-2. MORTGAGE TERMS.

a. Maximum Mortgage Amount. The maximum mortgage amount is
* governed by a loan-to-replacement cost limitation of 90 percent of the HUD-FHA estimate of the replacement cost of the property, including equipment, covered by the mortgage. *

(4-2) (1) Special limitations, in addition to those prescribed in the previous paragraph, are imposed when the project involves the rehabilitation of an existing structure. The character of the limitation depends upon whether the property is already owned by the mortgagor or is to be purchased or otherwise acquired. (See Paragraph 1-5.)

(a) If the property is owned by the mortgagor, the mortgage amount is adjusted so as not to exceed the HUD-FHA estimated cost of rehabilitation to which is added either the amount of any outstanding indebtedness on the property and on equipment which is to be included as a part of the security or 90 percent of the HUD-FHA estimated replacement cost of the property prior to rehabilitation, whichever of these amounts is the lesser.

(b) If the property is to be acquired by the mortgagor, the mortgage amount is adjusted so as not to exceed 90 percent of the HUD-FHA estimated cost of rehabilitation to which is added 90 percent of either the actual purchase price of the property or the HUD-FHA estimated value of the property prior to the rehabilitation, whichever of these amounts is the lesser.

(c) In estimating the value of the property prior to rehabilitation, in both the case of property owned or property to be acquired, and appropriate amount is added for the estimated current value of any existing equipment which is to be included as a part of the security. Also, the amount of any outstanding special assessments and the capitalized value of any ground rents based on leasehold ownership are deducted determining mortgage amount.

b. Amortization. The law requires that the mortgage be limited to a term of 25 years from the beginning of amortization of the mortgage. Approved terms for monthly payments, including curtail rates for reducing the principal amount of the mortgage will be prescribed by HUD-FHA.

c. Interest Rate. The mortgage will bear interest at a rate not exceeding that specified in the current HUD-FHA regulations.

d. Additional Payments Under The Mortgage. In addition to making monthly payments covering the principal and interest due under the mortgage, the mortgagor will be required to include in the monthly payment an amount sufficient to provide for the payment of HUD-FHA mortgage insurance premiums, taxes property insurance and any special assessments and ground rents, and the deposit to the reserve for replacements accounts.

e. Mortgage Insurance Premium. The mortgagor's monthly mortgage payments include an amount equal to one-twelfth of the annual mortgage insurance premium which the mortgagee is require to pay HUD-FHA.

4-3. FINANCING CHARGES. The mortgagee is permitted to obtain reimbursement from the mortgagor for the application, commitment and inspection fees paid to HUD-FHA. In addition, it may collect from the mortgagor an initial service charge of two percent of the principal amount of the mortgage, as reimbursement for the cost of closing the loan transaction. Financing charges, approved by HUD-FHA as reasonable, which are over and above the two percent initial service charge, may be collected from the mortgagor and either turned over to the permanent lender or retained by the construction lender.

4-4. MORTGAGE CREDIT ANALYSIS. The HUD-FHA mortgage credit analysis of a proposed project is made for the purpose of determining the acceptability of the transaction as an insurance risk. Evaluation of the risk involves a finding as to the credit reputation, capability, and financial responsibility of the sponsorship; the forecasting of the mortgagor's financial ability to complete the the project; and an appraisal of the adequacy of the prospective rental income to meet the expenses of operating the project. Mortgage Credit procedures and analysis are to be completed in accordance with Section 207 basic instructions Reference (4) of the Foreword except as herein modified.

a. The Financial Information to Be Submitted by sponsors will vary according to the type of project involved. Where a group practice facility is to be established by an existing nonprofit organization, the sponsor is required to submit a current balance sheet and operating statement on the existing organization and a comprehensive budget estimate covering the project under construction. Where a group practice

(4-4) facility is to be established by a newly formed nonprofit organization, the sponsor is required to submit a pro forma balance sheet and projected budget. In some instances financial statements of the principals connected with the sponsorship may be required.

b. In a Project Involving a Newly Formed Organization which will provide personal health services on a prepayment basis, complete details of the prepayment plan must be submitted, including the estimated number of subscribers, the rate schedule, the services to be provided, and the type of organization to be formed. The sponsor will be expected to establish, to the satisfaction of HUD-FHA, that the membership and income projections submitted have a reasonable expectation of realization, and that the projected income (supported by available capital if necessary) is adequate to meet all estimated financial obligations. Among the evidence that may be offered in demonstrating the reasonableness of the applicant's projections are the following:

(1) The existence of a sufficient base of employed population having access to health plans through employer or union health and welfare benefits.

(2) The adequacy of the dollar level of prevailing health and welfare benefits for supporting the proposal plan's premium structure.

(3) The availability of the public assistance funds, medicare and medicaid funds, and other public or private sources of revenue.

(4) The competitiveness of the proposed plan's rate and benefit structures in relation to alternative health plans available.

(5) The presence of a favorable social environment, including community support and the acceptability of the proposal under state and local laws.

(6) The expressed interest in and support of the proposed plan by responsible representatives of industry and labor groups. Tangible support may be established

by showing an expressed intention of making the new plan available to employees.

(7) Realistic estimates of the new plan's likely penetration of the market, and of the potential for membership growth.

c. Mortgagor Organization. When the mortgagor organization is to be established by participating practitioners, who are to lease the facilities for use in conducting a group practice, individual current financial statements of each practitioner may be required.

d. Financial Statements not submitted on FHA Form 2417, PERSONAL FINANCIAL AND CREDIT STATEMENT, must contain the certification which appears on the reverse side of FHA Form 2417.

NOTE: These statements must be supported by adequate schedules, a combined or consolidated statement, plus other financial data to the extent that such supporting information is necessary for determining the financial responsibility and capacity of the sponsorship.

e. Individual Factual Data Reports (and in some instances commercial credit reports) on the sponsors will be obtained by the Field Office when needed for proper credit analysis unless such reports have been furnished by the mortgagee.

4-5. VALUATION. Valuation analysis of an application for insurance under Title XI is made for the purpose of estimating the replacement cost of the property as security for a long term insured mortgage. The feasibility of the proposed project must be established, however, before its replacement cost can be determined.

a. The Proposed Project Will Be Considered Feasible Only if:

(1) A continuing market for the health services to be provided by the group practice is apparent.

(2) The project site is acceptable and the physical improvements thereon will be suitable for the intended purpose.

(3) The anticipated gross income to be received by the mortgagor, either from the direct operation of the facilities or from renting them to a group, will be

sufficient to meet payment requirements under the mortgage as well as all other project operating expenses including the required payments to reserves for replacement.

(4) The annual payment requirements under the mortgage, the annual reserve for replacements and all other project operating expenses total an amount which is not greater than the amount of the justifiable economic rent.

d. The HUD-FHA Estimate of Replacement Cost Of The Completed Project may include the land and the proposed physical improvements, equipment to be used in the facility, onsite utilities, architects' and builders' fees, legal and organization expenses, taxes and interest occurring during construction or rehabilitation, and other incidental charges approved by HUD-FHA.

(1) It will also include:

(a) A statement of the financial requirements to be met by the mortgagor and will specify conditions under which advances of mortgage proceeds will be made for organization and planning expenses, and

(b) Interim interest payments, land acquisition, site improvements.

(2) Within thirty days from the date of commitment, a commitment fee must be paid which, when added to the application fee, will aggregate $3.00 per $1,000 of the amount of the loan set forth in the commitment.

4-6. INSURANCE OF ADVANCES. Follow basic 207 instructions except as herein modified.

a. Initial closing. If the project involves HUD-FHA insurance of advances during construction, there will be an initial closing of the loan prior to the beginning of such construction.

(4-6)
* (1) At the closing, the working drawings and specifications, construction contract and FHA Form No. 2328, Contractor's and/or Mortgagor's Cost Breakdown, will be reviewed. The* mortgagor will provide HUD-FHA and the mortgagee with a survey of the site and a policy of title insurance or other title evidence satisfactory to HUD-FHA. Assurance

of completion of the facility will be provided in the form of a bond or escrow deposit of not less than 10 percent of the cost of construction. Required closing documents will be submitted to HUD-FHA and to the mortgagee.

(2) When all financial and other requirements called for in the commitment have been met, HUD-FHA will initially endorse the mortgage note for insurance.

b. Construction.

(1) Form of Contract. A "cost plus" form of contract will be used between the mortgagor and the general contractor unless it is established to HUD-FHA's satisfaction that such form is not required to protect its interests and the interests of the mortgagor, in which case a lump sum contract, arrived at by competitive bidding or negotiation, may be used. The cost-plus contract will provide for payment of the actual cost of construction of the project, not to exceed a specified maximum price; and may provide for payment of a fixed fee to the general contractor, which will not exceed a reasonable allowance as established by HUD-FHA in accordance with customary practice in the area.

(2) Prevailing Wages and Labor Standards. Prevailing wage rates and labor standards specified by the Secretary of Labor must be met under any contract, subcontract or agreement for the construction or rehabilitation of the project. When laborers or mechanics employed on the project work in excess of eight hours during any workday or in excess of forty hours during any workweek, they will be paid for such overtime at least one-half times the basic rate.

(3) Preconstruction Conference. Prior to initial endorsement, a preconstruction conference will be held to discuss requirements during the construction period.

(4) Commencement of Construction. Construction of the project may begin immediately after initial closing provided all local start of construction requirements have been met.

(5) Inspection. During the construction period, a HUD-FHA representative will visit the site from time to time to

inspect the work being done. The commitment may provide for the payment of an inspection fee in an amount
* not to exceed $5.00 per $1,000 of the amount of the loan set forth in the commitment. This fee must be paid at the time of initial endorsement. *

c. Cost Certification. When the project is completed the mortgagor and the contractor will be required to file with HUD-FHA their certificates covering the actual costs incurred in the construction of the project. Any subcontractor, supplier or equipment lessor having an identity of interest with the contractor will also be required to certify their costs. If the principal balance of the insured mortgage exceeds 90 percent of the certified costs, as approved by HUD-FHA, such excess will be applied to reduce the mortgage balance. See Reference (5) of the Foreword.

4-7. MORTGAGE CREDIT INSTRUCTION - PROCESSING FHA FORM 2264-Gp.

a. Part VIII - Determination of Maximum Insurable Mortgage.

* (1) Proposed Construction (Complete criteria 1, 3 and 4)

(a) The insurable mortgage will not exceed the lesser of:

1 The amount applied for

2 90% of the HUD-FHA estimate of Replacement Cost of the mortgage security.

3 An amount which entails a debt service not in excess of 95% of the sum of the net returns on improvements and the net indicated return from equipment. *

(4-7) (b) Criteria.

1 Enter amount applied for from FHA Form 2013GP-2.

*

2 Statutory dollar limit (Not Applicable). *

3 a Enter the Replacement Cost as shown on FHA Form 2264-GP, Part II-G. Enter the applicable percentage of Replacement Cost. Multiply the Replacement Cost by the percentage and record the product in Column 2.

b If leasehold, enter the value of the leased fee as indicated on FHA Form 2264-GP, Page 3 Part VI E 5.

c If subject to special assessment, enter the principal amount as shown on FHA Form 2264-GP, Page 3, Part V B.

d and e. Self-explanatory.

4 a Enter mortgage interest rate from FHA Form 2013 GP-2, Part II but not to exceed the rate fixed by HUD-FHA Regulations.

b Enter the mortgage insurance premium rate fixed by HUD-FHA Regulations.

c Enter initial curtail rate in conformity with the following:

The law requires that the mortgage be limited to a term of 25 years.

d Self-explanatory.

e Enter as "net income" the term sum of the amounts shown in FHA Form 2264-GP, Page, Part VI B 3 and P 1. Enter the applicable debt service percentage limitation. Multiply the amount entered as net income by the percentage and record the result in Column 2.

(4-7) f If leasehold, enter the amount of ground rent shown on FHA Form 2264-GP, Page 3 Part VI E 5.

g If subject to special assessments, enter the annual amount from FHA Form 2264-GP, Page 3, Part VB 3(b). However, if the assessments are non-prepayable and the payment term is ten years or more no entry is made for this term as the payments have been included as an operating expenses in valuation processing.

h i, and i Self-explanatory.

* (2) Rehabilitation. (Complete criteria 1, 3, 4, 5 and 6) *

(a) The insurable mortgage shall not exceed the lesser of:

1 The limits set forth under new construction.

2 Property Owned - HUD-FHA estimated cost of rehabilitation plus the lesser of (a) principal amount of existing indebtedness secured by the property, including indebtedness against equipment which is to remain a part of the security, if any, or (b) 90% of the HUD-FHA estimated "as is" value of the property and equipment and before rehabilitation after deduction of the leased fee, if leasehold. This amount is further reduced by the amount of special assessments, if any.

* (b) Criteria. Items 1, 3 and 4 - Complete as for proposed construction. *

5 a Enter total amount of all improvements & equipment from FHA Form 2264-GP, Page 2, Part II shown below C.3.

b Enter total cost for off-site requirements from FHA Form 2264-GP, Part VI, D.

c Enter the total carrying charges, financing charges, from FHA Form 2264-GP, Part II D 9., 10.

d Enter the total for legal and organization from FHA Form 2264-GP, Part II, E 3., 4.

e Sum of items a through d, inclusive.

f Enter the fair market value of the property before rehabilitation as shown in FHA Form 2264-GP, Part IV, B. Enter 90% in the space provided for percentage. Multiply the fair market value after deduction of the value of the leased fee if leasehold, by the percentage. This amount is further reduced by the amount of special assessments, if any, and entered in Column 1.

g Enter the amount of existing indebtedness which must be confined by the holder. This amount must reflect any discount allowed by the holder for prepayment of the debt, or may include any penalty required for prepayment.

h Self-explanatory.

i Insert 100 in the space provided for percentage. Multiply Item h by this percentage and record the product in Column 3.

Property To Be Acquired - 90% of the HUD-FHA estimated cost of rehabilitation plus the lesser of: (a) 90% of the actual purchase price of the property; or (b) 90% of the HUD-FHA "as is" value before rehabilitation (less value of leased fee, if leasehold, and/ or principal amount of special assessments, if any).

(c) Criteria. 5 a through 5.e - Complete according to criteria under "(b) Property Owned," above.

(4-7)

f Enter the HUD-FHA estimate of fair market price of property before rehabilitation from FHA Form 2264-GP, Part IV, B 2. (If leasehold, deduct leased fee). Enter 100 in the space provided for percentage. Record the product of the two entries in Column 1.

g Enter in Column 1 the purchase price of the property as shown in the purchase agreement or option.

h Self-explanatory.

i Insert 90 in the space provided for percentage. Multiply Item h by this percentage and enter product in Column 3.

6 a Enter estimated cost of total improvements, fees & allowances from FHA Form 22640GP, Part II, B.

(3) Maximum Insurable Mortgage

Enter as the maximum insurable mortgage the lowest of the amounts shown in Column 3.

(4) Reconciliation Of Estimates

(a) The mortgage amount assumed by the Valuator appears in the Item "FHA Mortgage Insurance Premium" on Page 2 of FHA Form 2264-GP. If this amount is different from the maximum insurable loan determined on Page 4 of FHA Form 2264-GP, it will be necessary to revise the entries on Page 2 of FHA Form 2264-GP for "Interest, FHA Mortgage Insurance Premium, FHA Examination Fee, FHA Inspection Fee, Financing Expense, Total Estimated Cost (exclusive of land and required construction off the site) and Total Estimate of Replacement Cost of Property."

(b) Such revisions shall be made by the Mortgage Credit Examiner, who will initial each change and enter the date-opposite the last change made. The "Total

Estimate of Replacement Cost of Property" as revised, should then be compared to the "FHA Estimate of Replacement Cost, the case should be returned to the Valuation Section for further review and any necessary adjustments. If the "FHA Estimate of Replacement Cost is changed as a result of these adjustments, it will be necessary for the Mortgage Credit Examiner to revise the estimate under Criterion 3. Whenever the total estimated cost (exclusive of site and required construction off the site) on Page 2, Part II, F 1 of FHA Form 2264-GP, is amended, it will be necessary to adjust criterion 4 (also Criteria 5 and 6 when applicable).

b. Part IX. Estimate Requirements for Completion of the Project. This portion of the form provides for the computation of the estimated requirements for completion of the project involving new construction. It will not be completed for rehabilitation projects.

(1) HUD-FHA Total Estimated Cost (exclusive of land and exclusive of required construction off the site). The Estimated Cost (exclusive of site and required

construction off the site)" which appears under Part II, F 1, Page 2 of FHA Form 2264-GP.

(2) Mortgage Loan Proceeds. Enter the amount of "Maximum Insurable Mortgage" from the schedule immediately above.

(3) Amount: required for completion of the project. Deduct Item 2 from Item 1.

(4) The amount of cash working capital to be escrowed at closing is obtained by taking 2% of the maximum insurable mortgage.

If a leasehold is involved and the lease provides for the payment of ground rent during the construction period, an amount sufficient to pay such ground rent shall be added to the 2% working capital and included in the required cash deposit. Under "Remarks" show the breakdown of the cash deposit (i.e.) :

2% Working Capital	$ __________
Ground Rent During Construction	$ __________
Total Cash Deposit	$ __________

(5) Enter the amount, if any, required to meet the deficiency between net income and debt service following completion of the project and until a sustaining operation will be realized.

(6) The Estimated Cost of Off-site Requirements is obtained from Part IV D, Page 2, FHA Form 2264-GP. No deduction is made for the estimated cost of improvements which might be installed at public or utility company's expense, inasmuch as the purpose of this item is to indicate to the Closing Attorney and the mortgagee the estimated total cost of off-site requirements. The estimated cost which will have to be assumed by the sponsors will be fully accounted for a closing.

4-8. MORTGAGE CREDIT INSTRUCTION FOR PROCESSING FHA FORM 2283. (See Appendix 18.)

a. Type of Transaction:

Insert "Group Practice Facilities" in the blank space and check the box preceding it.

b. Requirements for Completion:

Item 1. "Total for All Improvements" shall refer to the total estimated cost including all the specialized non-realty equipment included in the project cost. Enter the total amount as shown on FHA Form 2264-GP.

Item 4. Enter the exact amount called for in the actual contracts to be presented at closing after review by the Architectural Section. Architectural Section must determine whether all specialized non-realty equipment items included in project cost are included in the contracts.