

PROCEDURES FOR PROCESSING SECTION 8 MODERATE REHABILITATION
APPLICATIONS WITH HUD MULTIFAMILY MORTGAGE INSURANCE

1. PURPOSE: When HUD multifamily mortgage insurance programs are used in conjunction with the Section 8 Moderate Rehabilitation Program, there are some overlapping programmatic responsibilities for the staff of HUD Field Offices and Public Housing Agencies (PHAs). This Appendix clarifies the respective Field Office and PHA processing procedures and responsibilities in order to minimize unnecessary and duplicative staff actions.

Paragraphs 2 through 10 of this Appendix apply to Moderate Rehabilitation projects insured under any multifamily mortgage insurance program; Paragraph 11 addresses variations in Paragraphs 2 through 10 which apply specifically to Moderate Rehabilitation projects using the Section 223(f) program.

Generally, each paragraph of this Appendix summarizes the regular processing procedures for the Moderate Rehabilitation and mortgage insurance programs, and then describes the procedure to use when the two programs are combined. All other processing requirements and program standards applicable to either program will be met, except to the extent they are modified by this Appendix.

2. BACKGROUND. The Section 8 Moderate Rehabilitation Program is a program for upgrading rental units requiring eligible rehabilitation of at least \$1,000 per unit. This program is administered by local PHAs. The owner is responsible for securing financing for the rehabilitation and completing the rehabilitation work. Prior to rehabilitation, the owner and the PHA execute an Agreement to Enter Into a Housing Assistance Payment (HAP) Contract. Once the rehabilitation has been satisfactorily completed, the owner enters into a 15-year HAP Contract with the PHA which specifies the rents and requires the owner to rent the units to Section 8 eligible families. The rents include the monthly amounts necessary to meet operating expenses, amortize the rehabilitation costs, and allow a reasonable return on the owner's investment in the property. There is no statutory or regulatory maximum amount of rehabilitation which can be completed under the program; the extent of rehabilitation is limited by what can be amortized within the Section 8 Moderate Rehabilitation Fair Market Rents.

Under a HUD multifamily mortgage insurance program, HUD insures the lender against loss in the event the owner defaults on a mortgage loan. The Field Office is responsible for processing the proposal and monitoring the construction or rehabilitation of the project. In addition, since the HUD insurance is for the term of the mortgage, HUD also monitors the management of the multifamily project for the term of the mortgage insurance.

3. MINIMUM REHABILITATION STANDARDS, MINIMUM AMOUNT OF REHABILITATION

The Moderate Rehabilitation Program requires that Housing Quality Standards (HQS) (Sections 882.109 and 882.405 of the Moderate Rehabilitation regulations) or other HUD-approved standards such as local codes be used as the minimum rehabilitation standards; the mortgage insurance programs require that the Minimum Design Standards (MDS), HUD Handbook 4940.4, be followed.

The MDS will be the minimum rehabilitation standard for Moderate Rehabilitation mortgage insurance applications. The Field Office will ensure that the MDS are met and will determine whether the nature and amount of rehabilitation required is appropriate to qualify the project for mortgage insurance. If the PHA has already completed a work write-up and cost estimates, these will be forwarded to the Field Office (see Attachment 1) and will be used for guidance. The Field Office is also responsible for ensuring that energy conserving improvements that are practicable, cost effective, and financially feasible are accomplished in accordance with the Cost-Effective Energy Conservation Standards (24 CFR Part 39).

If an owner applies for the Moderate Rehabilitation Program after receiving a feasibility letter, a conditional commitment or a firm commitment for HUD mortgage insurance, the PHA need not complete a work write-up and cost estimates since these actions will be taken by the Field Office. The HUD work write-up and cost estimates will be preliminary when the application has been approved for a conditional commitment and final when the application has a firm commitment. The PHA will follow its normal screening and selection procedures, but will use HUD's work write-up and cost estimates. The PHA will complete its initial inspection to ensure that \$1,000/unit of eligible rehabilitation work, including caulking and weatherstripping, will be completed.

4. AFFIRMATIVE FAIR HOUSING MARKETING PLAN AND MANAGEMENT DOCUMENTS

In the Moderate Rehabilitation Program, the PHA's approved application includes an Equal Opportunity Housing Plan. For the mortgage insurance program, the owner submits an Affirmative Fair Housing Marketing Plan with the mortgage insurance application.

When the two programs are combined and all the units in the project will be assisted, it is not necessary for the owner to submit a marketing plan since the PHA will be responsible for referring eligible applicants to the owner for selection. However, if the insured Moderate Rehabilitation project will be partially assisted, the owner must include an Affirmative Fair Housing Marketing Plan

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with the mortgage insurance application since the owner will be responsible for marketing the unassisted units. In addition, when there are units in the project which are no longer assisted, the owner must submit to HUD an Affirmative Fair Housing Marketing Plan which will apply to the formerly assisted units, if the owner has not already submitted a plan; this will normally occur upon expiration of the 15-year HAP Contract.

The Moderate Rehabilitation Program and the mortgage insurance programs require that a management plan be submitted with the owner's application. The required information is similar and it should be possible to process one set of management documents for both programs.

5.DAVIS-BACON WAGE RATES

The requirements under the Davis-Bacon Act vary among mortgage insurance programs and the Moderate Rehabilitation Program. The Moderate Rehabilitation Program requires compliance with the Davis-Bacon Act when an Agreement covers nine or more assisted units; for Section 221 projects, Davis-Bacon applies to projects consisting of five or more units. For purposes of using mortgage insurance with the Moderate Rehabilitation Program, the stricter of the applicable Davis-Bacon requirements will be used. HUD is responsible for monitoring owner compliance with Davis-Bacon requirements.

6.RENT CALCULATION

For the Moderate Rehabilitation Program, the PHA calculates a rent to cover the costs of rehabilitation and maintaining and managing the unit. The PHA also establishes a base rent which excludes the fixed amortization amount of the rehabilitation loan. Generally, annual adjustments are applied to the base rents rather than the Contract Rents since the debt service on the rehabilitation loan is not subject to inflation. For a mortgage insurance program, the Field Office establishes rents on the basis of a market comparability analysis. In addition, when a project is being rehabilitated using the Section 8 Substantial Rehabilitation Program, an allowance of up to 20 percent above a rent based on market comparison is allowed with cost justification.

When the two programs are combined, the calculated rents plus any applicable utility allowances must not exceed the Section 8 Moderate Rehabilitation Fair Market Rents (FMRs) or the approved exception rents. As explained in Section 882.409 of the Moderate Rehabilitation regulations, FMRs are maximum rents which the Contract Rents plus any applicable utility allowances cannot

normally exceed; the FMR schedule for Moderate Rehabilitation is 120 percent of the Existing Housing FMR schedule. There are, however, certain specific conditions described in Section 882.409 under which the Section 8 Moderate Rehabilitation FMRs may be exceeded by up to 10 percent, and in these cases, new maximum rents can be established. These new rents are called exception rents. (The need for an increase above the Moderate Rehabilitation FMR because a mortgage insurance program is being used is not reason by itself to approve an exception rent.)

If the PHA has selected an owner's proposal for the Moderate Rehabilitation Program prior to the owner receiving a HUD feasibility letter, conditional commitment or firm commitment, the PHA will notify the Field Office and provide any necessary information which will be helpful in the Field Office's processing. (See Attachment 1 for a sample letter.)

For Moderate Rehabilitation insured projects, the rents calculated by the PHA using the procedures contained in Handbook 7420.3 REV (including the policy concerning work items eligible for amortization through the Contract Rents) will be used unless the Field Office Manager or Supervisor determines that such rents are inappropriate for mortgage insurance purposes. In such cases, the Field Office Manager or Supervisor is hereby delegated the authority to waive, on a case-by-case basis pursuant to 24 CFR 899.101, Section 882.409(c) of the Moderate Rehabilitation regulations (and the applicable implementing instructions contained in Handbook 7420.3 REV.) in order to calculate the Contract Rents in accordance with the mortgage insurance procedures or, with cost justification, the procedures established for Section 8 Substantial Rehabilitation insured projects. (Any waivers of Section 882.409(c) must be in writing signed by the Field Office Manager or Supervisor, and the waiver approval and supporting documentation must be retained in the project file.) The Field Office will establish a base rent by subtracting an actual or imputed amount for the amortization of the rehabilitation expenses from the Contract Rent. The established base rent cannot exceed the Section 8 Existing FMRs or exception rents.

If the rents calculated by mortgage insurance procedures are insufficient to support 90 percent of the replacement cost estimate and the estimate of project operating expenses, as well as provide a reasonable return to the owner, the Field Office may follow the procedures in Handbook 7420.2 REV. (Section 8 HAP Program - Substantial Rehabilitation Processing Handbook), Chapter 9, for determining rents. This will allow an increase of up to 20 percent above the rent computed by market comparison but only with cost justification. (Note: A request for higher rents based on higher management costs associated with Section 8 tenant eligibility and

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re-certification or advertising to fill vacancies should not be granted since the PHA performs these functions for the owner in the Moderate Rehabilitation Program.) For applications for mortgage insurance for projects in which less than 100 percent of the units will be assisted, it will be necessary to complete an additional rent formula, Exhibit F to Chapter 9 Handbook 7420.2 REV, Section 8 Rent Formula for Unassisted Units - Insured Mortgages.

The rents calculated by the Field Office will be compared to the Section 8 Moderate Rehabilitation Fair Market Rents or exception rents. If they are within these maximums, the PHA will be informed by the Field Office Manager or Supervisor and the processing can continue. If the rents needed for the insured project are higher than the maximum rents allowed under the Moderate Rehabilitation Program, the project would be infeasible for mortgage insurance with Moderate Rehabilitation assistance. Another form of Moderate Rehabilitation financing would have to be found, unless the owner will accept the maximum rents allowed under the Moderate Rehabilitation Program and the resulting reduction in the mortgage amount. The owner might also choose to proceed with the mortgage insurance application without the Section 8 Moderate Rehabilitation assistance. In all cases, it will be very important for the Field Office, the PHA, and the owner to maintain close contact concerning the rent calculations.

If an owner applies to the PHA after receiving a HUD feasibility letter, conditional commitment or firm commitment for mortgage insurance, the PHA will not need to complete the Moderate Rehabilitation rent calculations but must check to be sure the rents calculated by the Field Office do not exceed the Moderate Rehabilitation FMRs or HUD-approved exception rents. The PHA must also ensure that the property is eligible and that at least \$1,000 per unit of eligible rehabilitation is going to be accomplished.

If the proposal is selected by the PHA for the Section 8 Moderate Rehabilitation Program, the owner or PHA should inform the HUD Field Office. In most cases, the rents calculated by the Field Office (before the Moderate Rehabilitation proposal was approved) will have been based on market comparability and will not have been calculated using Handbook 7420.2 REV. Since the Field Office now has been informed that the Section 8 Moderate Rehabilitation Program will be involved, they can reprocess the application using the instructions contained in Chapter 9 of Handbook 7420.2 REV, if costs justify this. The Field Office Manager or Supervisor will have to approve a waiver of Section 882.409(c) of the Moderate Rehabilitation regulations in order to utilize the mortgage insurance or Section 8 Substantial Rehabilitation rent calculation procedures.

7. AGREEMENT EXECUTION

The execution of the Moderate Rehabilitation Agreement (Forms HUD-52538A and B) by the owner and the PHA will always occur prior to the start of rehabilitation. For projects involving insurance of advances, the Agreement must be executed prior to or at the time of the initial endorsement for mortgage insurance. For projects involving insurance upon completion, Firm Commitment must be issued before execution of the Agreement.

When executing the Agreement, the PHA is responsible for ensuring that Contract Rents plus any applicable utility allowances do not exceed the Moderate Rehabilitation FMRs or exception rents.

8. INSPECTIONS, REHABILITATION COMPLETION, AND HAP CONTRACT EXECUTION

In the Moderate Rehabilitation Program, the PHA is required to make an initial inspection of the property to determine the specific work items which need to be accomplished. The PHA is also required to inspect, as appropriate, the property to ensure the work is proceeding on schedule and is being accomplished in accordance with the Agreement. A final inspection must also be conducted by the PHA to determine that the work has been completed properly.

For HUD mortgage insurance programs, the Field Office is required to make a joint inspection with the owner or the owner's representative to determine the required rehabilitation work items to be included in the work write-up. During rehabilitation the Field Office is required to make inspections. When all the work covered by the construction contract is complete, the Field Office must perform a final inspection.

When the Moderate Rehabilitation Program and a mortgage insurance program are combined, the PHA will perform an initial inspection and a final inspection, but not inspections during rehabilitation. The Field Office will complete all inspections as required by the mortgage insurance programs, including inspections during rehabilitation. The Field Office will make the final determination with respect to the work to be done and satisfactory completion.

Upon completion of rehabilitation, the owner will submit to the Field Office and to the PHA the evidence of completion detailed in Section 882.510 of the Moderate Rehabilitation regulations. (The owner will also submit to the Field Office all other required mortgage insurance documents.) The Field Office will notify the PHA of the date and time of its scheduled inspection so that the PHA, if convenient, may make its final inspection simultaneously with the Field Office's final inspection. The Moderate Rehabilitation HAP Contract (Forms HUD-52539A and B) will be executed between the

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PHA and the owner when the Field Office finds that the evidence of completion and the rehabilitation are acceptable.

9.COST CERTIFICATION

The Moderate Rehabilitation Program requires owners to submit a cost certification to the PHA prior to its acceptance of the units and execution of the HAP Contract in order to determine the necessity of recalculating the contract rents. The mortgage insurance programs require the mortgagor to submit a certificate of actual costs, prior to final endorsement, in accordance with the applicable regulations and handbooks.

When the two programs are combined, the owner will be responsible for certifying the actual costs for the rehabilitation to the Field Office in the manner required by mortgage insurance procedures and providing a total rehabilitation cost figure to the PHA. The Field Office will be responsible for the cost certification process and any necessary adjustments to the mortgage amount or rents. Any adjustments to the rents listed in the Agreement must comply with Section 882.409(d). The applicable FMRs are those in effect at the time of execution of the Agreement.

10.REGULATORY AGREEMENT

The correct Regulatory Agreement to be executed between HUD and the owner is Form HUD-92465, Regulatory Agreement for Insured Multifamily Housing Projects (with Section 8 Housing Assistance Payments Contracts).

11.SECTION 8 ANNUAL AND SPECIAL RENT ADJUSTMENTS

The Section 8 Annual Adjustment factors published at least annually by HUD will be used to adjust the Contract Rents on or after each anniversary date of the HAP Contract as described in Section 882.411 of the Moderate Rehabilitation regulations. (See also paragraph 6 of this Appendix regarding the establishment of base rents.)

Contract Rents will be adjusted upon submission to the PHA by the owner of a revised schedule of Contract Rents, provided the units are in decent, safe, and sanitary condition and that the owner is in compliance with the terms of the lease and the HAP Contract. The PHA will make the necessary adjustments to the rents as a result of the annual adjustment request and notify the Loan Management Branch in the Field Office of the adjusted rents.

The owner can also request a special adjustment from the PHA, subject to HUD approval, for increases as discussed in Section 882.411 of the Moderate Rehabilitation regulations.

12.MANAGEMENT REVIEWS

The insured Moderate Rehabilitation project will be viewed by the Field Office as an insured project with Section 8 assistance. The Field Office will be responsible for completing management reviews of the PHA for its administration of the Moderate Rehabilitation Program in accordance with Handbook 7420.3 REV and of the owner for the owner's responsibilities under the HUD mortgage insurance program in accordance with Handbook 4350.1. Where possible, duplication of monitoring responsibilities (i.e., annual unit inspections) by both the Assisted Housing Management and Loan Management staff should be avoided.

13.SECTION 223(f)

Since the Section 223(f) program establishes a dollar limit for the amount of work which can be completed on a project, it may be of only limited use for the Moderate Rehabilitation Program. In deciding if it is feasible for a Section 8 Moderate Rehabilitation project to be combined with the Section 223(f) program, the Field Office must be sure that there are not significant levels of work required which would cause the rehabilitation costs to exceed 15 percent of the final estimate of value after repairs or \$3,000 per unit, whichever is greater, as determined by HUD.

When processing a Section 8 Moderate Rehabilitation proposal with the Section 223(f) program, Handbook 4565.1 (Mortgage Insurance for the Purchase or Refinancing of Existing Multifamily Housing Projects - Section 223(f)) will be followed, with the variations listed below:

a.Minimum Rehabilitation Standards, Minimum Amount of Rehabilitation and Eligible Work items

The project must require a minimum of \$1,000 of Moderate Rehabilitation eligible work items per unit. Routine maintenance and luxury items cannot be counted toward this \$1,000 minimum requirement. The Field Office will be responsible for ensuring that the rehabilitation brings the project into compliance with the General Acceptability Criteria of the Minimum Property Standards.

b.Davis-Bacon Wage Rates

Although the Section 223(f) Program does not require compliance with Davis-Bacon, the Moderate Rehabilitation Program requires

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compliance in projects with nine or more assisted units. Therefore, if Section 223(f) insurance is used in projects with nine or more Moderate Rehabilitation units, Davis-Bacon wage rates will apply. The Field Office will monitor compliance with this requirement.

c. Fair Housing Marketing Certification

The Section 223(f) program requires that a "Fair Housing Marketing Certification" be submitted at the firm commitment stage. If the project will be partially assisted, the owner must submit this certification since the owner will be responsible for marketing the unassisted units. If all the units in the project will be assisted, it is not necessary for the owner to submit this certification. However, when there are units in the project which are no longer assisted, the owner must submit to the Field Office this certification, if the owner has not already done so; this will normally occur upon expiration of the 15-year HAP Contract.

d. Rent Calculations

Similar to the procedure outlined in paragraph 6, the rents will be calculated in accordance with the Moderate Rehabilitation regulations and Handbook 7420.3 REV, unless the Field Office Manager or Supervisor exercises the delegated authority to waive Section 882.409(c) in order to utilize the Section 223(f) procedures for determining initial Contract Rents. In any event, the established Contract Rents plus any applicable utility allowances cannot exceed the Moderate Rehabilitation FMRs or exception rents in effect when the Agreement was executed, and the base rents plus any applicable utility allowances cannot exceed the Existing Housing FMRs or exception rents.

If the Field Office determines it necessary to utilize the Section 223(f) rent calculation procedures, an income estimate will be completed, and the rents established by market comparison will be compared with the Section Moderate Rehabilitation Fair Market Rents or exception rents. Any comparison rents which exceed the FMRs or exception rents, if applicable, less Personal Benefit Expense (utility allowance), must be reduced. This corresponds with Paragraph 5-6 of Handbook 4565.1.

The Section 8 approvable Contract Rents shall be those rents shown in Section C of Form FHA-2264. It should be noted that

20 percent cannot be added to the rents determined appropriate by market comparison; the rent formula to be used is the Rent Formula for Existing Rental Housing under Section 223(f) in Handbook 4565.1. A valuation checklist is not necessary.

If any action before endorsement should reduce Contract Rents, the case must be reprocessed for reduction of income estimates, and possible reductions of value and/or mortgage amount.

e. Agreement Execution

The Agreement will be executed prior to the start of rehabilitation and since Section 223(f) is always insurance upon completion, after a firm commitment for mortgage insurance has been made.

f. Cost Certification

After completion of rehabilitation, Field Office acceptance of the units, and execution of the HAP Contract, the modified form of cost certification shall be completed in accordance with Handbook 4565.1. The owner will also notify the PHA of the total approved cost of rehabilitation completed.

SAMPLE LETTER

Section 8 Moderate Rehabilitation Program
PHA Notification to HUD of Selection of Owner Proposal
Prior to HUD Commitment for Mortgage Insurance

Field Office Manager or Supervisor:

This is to inform you that _____ (project name) has been selected by this agency for assistance under the Section 8 Moderate Rehabilitation Program. This agency intends to execute an Agreement to Enter into a Housing Assistance Payments Contract with _____ (owner) for _____ (number) units upon receiving evidence that financing has been secured for the _____ (purchase/refinancing) and rehabilitation of the subject property. In the event this application for mortgage insurance is approved, a firm commitment will be required before we execute an Agreement.

This agency has inspected the property, developed preliminary work write-ups and cost estimates, determined tenant eligibility, and has calculated the Contract Rents (less any applicable utility allowances) for the units to be assisted, in keeping with the Moderate Rehabilitation Program requirements for a feasibility analysis. The preliminary work write-up and cost estimates, supporting documentation used in the rent calculation, and a copy of the owner's Management Plan are enclosed for your use.

Based on our preliminary feasibility analysis of the project, we are able to provide the following information on project rents for your use:

No. of Units	Contract Rent	Contract Rent Plus Utility Allowance	Moderate Rehabilitation Fair Market Rent (or HUD-Approved Exception Rent)
0 BR			
1 BR			
2 BR			
3 BR			
4 BR			
5 BR			

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We realize that if the project is approved for mortgage insurance, HUD will develop a final work write-up reflecting the physical standards required by the mortgage insurance program. We also realize that HUD will develop final rent figures; these initial rents plus any applicable utility allowances must be within the FMRs or approved exception rents shown above.

We are working within certain time constraints set forth by the Moderate Rehabilitation Program. Specifically, the Moderate Rehabilitation Program requires that all units be rehabilitated and leased within at least 24 months of the date of the Moderate Rehabilitation ACC. Since our ACC is dated _____, the HAP Contract must be executed by _____ (date). We estimate that rehabilitation will take approximately ____ months; therefore, our target date for execution of the Agreement and Initial Endorsement (or Firm Commitment for insurance upon completion and Section 223(f) projects) is _____. Please contact us if this schedule cannot be adhered to.

We understand that HUD has no obligation to approve mortgage insurance for this project and that HUD will follow its normal methods in determining the project's acceptability for mortgage insurance.

The contact person at this agency for the subject project is _____ (staff person) who may be reached at _____ (phone number).

We look forward to working with you on this project.

PHA Executive Director

Enclosures:

- (1) Work Write-Up and Cost Estimates
- (2) Rent Calculations and Supporting
Owner Expense Data
- (3) Addresses of Units to be Assisted
- (4) Owner Management Plan