

MORTGAGEE LETTER 96-23

TO: ALL APPROVED MORTGAGEES

SUBJECT: Single Family Loan Production - Seven-Unit Limitation

The seven-unit limitation prohibits any borrower, including non-profit organizations, state and local government agencies, and private investors from obtaining FHA-insured financing for a property that may be rented if it has or will have a financial interest in more than seven rental units (regardless of financing type) in a contiguous area, generally defined as within a two-block radius. This regulation is designed to limit FHA's insurance exposure on multiple mortgages to any one borrower in any one area. The seven-unit limitation appears in our regulations at 24 CFR 203.42(a) and is also stated in paragraph 3-9 of Handbook 4155.1 Rev-4, Change 1 and, specifically for the Section 203(k) program, in paragraph 4-6 of Handbook 4240.2 Rev-2.

It has come to our attention that there has been some inconsistency in the application of the seven-unit limitation to non-profit and governmental mortgagors using Sections 203(b) and 203(k), as well as private investors using the Section 203(k) mortgage program, when the stated intent is to resell the mortgaged property to an owner-occupant. Some lenders and borrowers have interpreted the seven-unit limitation as not applicable in these circumstance even though FHA has never adopted that interpretation in any official issuance. Further, although our credit policies permit certain categories of institutional and investor borrowers to obtain the same high percentage of financing as typical owner-occupants, we do not consider these purchasers as "owner-occupants" for any purpose. Because of the confusion that apparently exists, we are issuing this mortgagee letter to clarify the proper interpretation of the seven-unit limitation.

Discussed below are those circumstances where the seven-unit limitation either does not apply or may be waived by FHA.

- I. Exclusion for Units Under Contract to be Re-sold: When a non-profit mortgagor or governmental entity under any single family mortgage insurance program, or a private investor under the Section 203(k) program, is acquiring properties, we presume such properties are being purchased for rental purposes even if homeownership is the eventual goal, and, thus, count those units toward the seven-unit limitation; this includes mortgages using the escrow commitment procedures under Section 203(k). However, to accommodate those mortgagors that will immediately re-sell the properties to qualified occupant owners, this presumption will not apply for those units that will be re-sold provided the mortgagor can provide conclusive evidence that the properties are under contract to the eventual occupying owner. This, at a minimum, requires presentation of a bona fide sales agreement and evidence the eventual owner occupying borrower has been approved for a new mortgage or assumption of existing mortgage.

For example, a non-profit may be in the process of purchasing and rehabilitating a dozen housing units in one neighborhood, half of which will be immediately re-purchased by low- and moderate-income first-time homebuyers, all of whom have been pre-qualified by the lender for qualifying assumptions. In this case, those units for which there are sales agreements that will be consummated once the rehabilitation work is complete can be ignored in counting toward the seven unit limitation.

- II. Redevelopment Areas and Section 203(k) Mortgage Financing: In certain areas targeted for redevelopment, 24 CFR 203.42(b) provides that the seven unit limitation regulation does not apply on Section 203(k) mortgages if: (1) the neighborhood has been designated by the state or local government for redevelopment or revitalization and (2) the government authority has submitted a plan that clearly defines the revitalization area as well as describes substantial public and/or private commitments made to revitalize the area. Therefore, no regulation waiver is needed in these circumstances to exceed the seven-unit limitation.

The exception for Section 203(k) redevelopment areas is discussed in more detail in paragraph 4-6 of Handbook 4240.2 Rev-2. Although no specific regulation waiver is needed, the handbook provides for direct involvement of the local FHA office before it will endorse mortgages on more than seven units for a borrower in the redevelopment area. FHA does not approve redevelopment plans per se, but it does reserve the right to withhold the exemption from the seven-unit limitation if the plan does not adequately describe the specific targeted area or the extent of the public-private commitment to achieve revitalization. The local FHA office may also impose a unit limitation based on the past performance of the borrower. Circumstances that may trigger a unit limitation would include when the borrower (a) will own more than 10 percent of the housing units in the designated redevelopment area or, (b) has more than eight units on adjacent lots in the designated redevelopment area. The FHA office may impose whatever unit limitation above seven that it believes is prudent under the circumstances and will consider the number of housing units in the targeted area as well as the level of governmental and private support in making this evaluation.

If a lender anticipates processing Section 203(k) mortgage loans in a redevelopment area that necessitates an exemption from the seven-unit limitation, it must submit a copy of the governmental unit's revitalization plan to the local FHA office and also identify the purchasing entity. Generally, those borrowers with proven track records in developing affordable housing will not have a unit limitation invoked. The local FHA office has 30 days from the time of receipt to notify the lender that a specific unit limitation has been adopted for that particular borrower. For all borrowers, the seven-unit limitation of the regulation always applies for properties outside a redevelopment area even if using Section 203(k) mortgage financing, including the escrow

commitment procedure.

- III. Projects in Progress Without Seven-Unit Waivers: We recognize that some lenders and borrowers may have inadvertently interpreted our regulations as exempting them from the seven-unit limitation and have begun projects that require seven-unit waivers. So as not to disrupt any on-going projects and/or cause undue financial harm, the seven-unit limitation in the regulations is hereby waived if the borrower can demonstrate that the project meets the criteria set forth below. This waiver covers the entire project as presented to the lender when the initial loan application was made and includes Section 203(b) as well as Section 203(k) financing. The lender or borrower must present the following to the FHA office having jurisdiction where the project is located and must do so within 60 days of the date of this mortgagee letter in order for the waiver to be applicable:

Project Description. The project description, as presented to the lender, must be submitted to FHA. It must identify the borrower, describe the location of the project and the number of units involved, as well as the current status, e.g., number of units already mortgaged, units rehabilitated, units sold to owner-occupants, etc. It must also describe whether the project is designed for immediate re-sales to owner-occupants or as long-term rentals to low- and moderate-income families and the type of financing, i.e., Section 203(b) or 203(k).

Contracts for Purchase and Mortgage Approval. In establishing the on-going nature of the project, the lender or borrower must provide copies of the sale(s) contracts for the properties that will constitute the project. The mortgage lender must also have issued at least one mortgage approval to the borrower within that project prior to the date of this mortgagee letter.

Once this submission is made the waiver will be applicable unless the local FHA office, within 30 days of receiving the documents and descriptions listed above, notifies the lender or borrower that the project does not meet the criteria for a waiver. FHA also reserves the right to withhold a seven-unit waiver if the local FHA office has previously acted and declared that a unit limitation was appropriate or has denied a seven-unit waiver for that specific project.

- IV. Specific Seven-Unit Waivers: If a mortgage (whether insured under Section 203(b) or 203(k)) is subject to the seven-unit limitation as described by this mortgagee letter, and the preceding waiver for projects in process does not apply, the mortgage will not qualify for insurance unless a waiver is granted by the Federal Housing Commissioner. All waiver requests must originate with the FHA office having jurisdiction where the

properties are located and must have the recommendation of the local office when it is forwarded to FHA Headquarters.

In evaluating whether or not good cause exists to grant a specific waiver to the seven-unit limitation, FHA will consider whether its exposure to insurance risk is acceptable. This evaluation may include, but is not limited to, an assessment of the track record and experience of the borrowing entity, the anticipated absorption rate of those properties into the rental or re-sale market, whether the seven-unit waiver will help contribute to additional affordable housing opportunities in the area and/or result in substantial rehabilitation of an area.

For non-profit agencies and governmental units, these specific waivers may include the use of Section 203(b) or Section 203(k) rehabilitation mortgage insurance. For private investors, the waiver may only be granted for Section 203(k) mortgages.

- V. Condominium Information: As stated earlier, although we permit certain non-occupying borrowers the same percentage of financing as available to typical occupant-owners, such mortgages are not considered as having been made to owner-occupants. This, among other things, precludes the use of adjustable rate and graduated mortgages.

Similarly, such mortgages in Section 234 condominium projects do not count toward the owner-occupancy requirements that must be met before FHA will insure any mortgages within the project. Specifically, statute requires that 80 percent of all FHA-insured mortgages covering units in a condominium project be occupied as principal or secondary residences, and our regulations further require that 51 percent of all units in the project, including those with FHA-insured mortgages, be occupied as principal or secondary residences. The 80 percent owner-occupancy requirement may not be waived.

Summary:

- ☐ All borrowers, regardless of type (non-profit, private investor, state or local government agency) are subject to the seven-unit limitation.
- ☐ Properties that will be immediately re-sold to actual owner-occupants may be exempted from counting toward the seven-unit limitation provided sales agreements are executed and the owner-occupant mortgagors are pre-qualified (see I, above).
- ☐ Section 203(k) mortgages in certain redevelopment areas are exempt from the seven-unit limitation unless the local FHA office determines that a unit limitation should apply. This does not require issuance of a specific waiver identifying the borrower or location of the properties but does permit the local FHA office to withhold the exemption (see II).

- For on-going projects (except those granted exemptions in redevelopment areas using Section 203(k) mortgage insurance), an automatic waiver applies provided that the local office receives the required submission documents within 60 days of this letter and the project meets the criteria described previously. The waiver may include either Section 203(b) or Section 203(k) mortgages (see III).
- Those circumstances not qualifying for exemption or automatic waiver (as described in II and III) must apply to the local FHA office for a specific seven-unit waiver (see IV).
- Condominium units that are owned by non-profit agencies, government agencies and private investors, do not count toward the 80 percent and 51 percent owner-occupancy requirements (see V).

If you have any questions regarding this issue, please contact your local FHA office.

Sincerely,
Nicolas P. Retsinas
Assistant Secretary for Housing-
Federal Housing Commissioner

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