Chapter 3

Eligible Multifamily Mortgage Insurance Programs

3.1 Introduction

This chapter contains the basic program requirements for the HUD/FHA multifamily mortgage insurance programs for which MAP Lenders can submit pre-applications and Firm Commitment applications. Other multifamily mortgage insurance programs such as Section 241 Supplementary Financing for Insured Project Mortgages are eligible under TAP or Traditional Application Processing and where local Hub and Program Centers offer fast track processing of this program. Section 241 and other multifamily insured programs will be added to MAP in the future.

3.2 General

The following requirements or program features apply to *all* HUD mortgage insurance programs:

A. Regulatory Agreement. All mortgagors must execute a HUD regulatory agreement governing the operation of the project. The regulatory agreement will be recorded at initial endorsement.

B. Sole asset. The mortgaged property must be the only asset of the mortgagor (borrower).

C. Non-recourse. The HUD mortgage note may contain a non-recourse provision, if the Lender agrees. (See Section 12.1.10 for exculpatory language.)

D. Fixed interest rate. The interest rate on a HUD insured loan is negotiated between the mortgagor and mortgagee and must be fixed for the term of the mortgage. The interest rate is fixed at initial endorsement for Insurance of Advances cases and at the start of construction for Insurance Upon Completion cases. For mortgage increases, a higher or lower rate may be fixed for the *increase only.*

E. Amortization plan. All HUD insured mortgages must be amortized through a level annuity monthly payment plan (LAMP), which requires equal monthly payments of principal and interest. LAMP variations are permissible for transactions involving bond financing and/or tax abatement.

F. HUD application fee. The HUD Firm Commitment application fee is $3 per thousand of requested mortgage amount.

G. HUD inspection fee. The HUD inspection fee is $5 per thousand of mortgage amount for new construction and $5 per thousand of improvement costs for substantial rehabilitation. The inspection fee for loans insured pursuant to Section 223(f) is

1. $30 per unit where the repairs are $3,000 or less per unit.
2. 1% of the cost of repairs where repairs are more than $3,000 per unit or the loan is insured under 232/223(f).

H. HUD mortgage insurance premium. The HUD construction and annual mortgage insurance premiums are based on a percentage of the mortgage amount and may vary, depending on the type of project mortgage. The initial premium is payable in advance at initial endorsement/loan closing.

I. Mortgagee fees and charges. The maximum financing fee the Lender may charge is 3.5% of the mortgage amount. (Higher fees up to 5.5% are permissible in bond transactions, for all MAP eligible programs. See Chapter 8 for details.) MAP Lenders can include Third Party costs as a mortgagable soft costs in the mortgage calculations. Include Third Party costs, i.e., appraisal, market study, PCNA, with Other Organization Costs, if any, in Section G., line 65 of Form HUD 92264. Third Party costs are included in the calculation of BSPRA where it is applicable. On the Form HUD-92264 HCF include Third Party costs along with any Organization Costs under Section H., Line 32.

The MAP Lender's Third Party Costs, reflected in Organization Costs are exempted from the 65 % initial endorsement disbursement rule. The rule only applies to the mortgagor's organizational costs.

J. Fair Housing and Equal Opportunity. Mortgagors and all contractors and subcontractors must comply with all HUD Fair Housing and Equal Opportunity requirements, including selection of occupants, employment, physical and programmatic accessibility (See 24 CFR Part 100 and subsequent sections), and "Affirmative Fair Housing Marketing" (24 CFR Part 200.600 and Handbook 8025.1 Revision 2).

K. Previous Participation. All principals in the proposed transaction must submit detailed information on Form 2530 regarding previous participation in governmental housing transactions in order to be approved by HUD for participation in any program of mortgage insurance.

L. Occupancy. Except in the case of a project specifically designed exclusively for the elderly (age 62 and over) or insured under Section 232, the mortgagor must certify that it will not discriminate against families with children.

M. HUD's Fiscal Procedures are contained in HUD Handbook 4410.1 Revision 2.

N. Bridge or Gap Financing. This is generally defined as, a loan spanning the gap between the termination of a short-term loan and the start of another long-term loan and is permitted as long as any recent indebtedness placed against the project was not in an effort to increase the mortgage or circumvent outstanding policy.

O. Transient Housing/Hotel Services Prohibition. Section 513 of the National Housing Act prohibits the use of the mortgage insurance programs for transient or hotel purposes. Leases for less than 30 days are prohibited. The mortgagor cannot execute leases for less than 30 days nor provide occupants with hotel services such as maid service, furnishing and laundering of linens, room service and bellboys.

P. Small Properties. Small properties may be processed using MAP, however, there are no special processing procedures for these projects.

3.3 New Construction/ Substantial Rehabilitation Multifamily Rental Apartments: Eligible Programs – Sections 221(d)(4), 221(d)(3), and 220

MAP Lenders can submit requests for pre-application review and Firm Commitment applications for the following programs

- Section 221(d)(4): general
- Section 221(d)(3): nonprofit mortgagor only
- Section 220: private or public

Condominium project mortgages (under Section 234(d)) and Cooperatives (under Section 213 or Section 221(d)(3)) are not currently eligible for MAP review procedures. Programs that are not currently covered by MAP may still be processed using the applicable processing center’s TAP or pre-MAP FASTRACK Guidelines until such time as MAP is expanded to include that program.

3.4 New Construction/Substantial Rehabilitation Multifamily Rental Apartments: Requirements and Program Features

A. HUD can insure loans for 5 or more residential units with complete kitchens and baths for both the construction and permanent loan (called Insurance of Advances) or just the permanent loan (called Insurance Upon Completion).

B. New Construction: generally, proposed construction of improvements where no work has been done to the site prior to the initial endorsement of the loan.

1. Work can begin after issuance of a HUD Firm Commitment with specific approval case-by-case from the HUD Field Office using the Early Construction Start process.
2. Construction may not start on Insurance Upon Completion projects until issuance of a Firm Commitment.

C. Substantial Rehabilitation: a property qualifies as substantial rehabilitation if it meets one of the following criteria:

1. The cost of repairs, replacements and improvements exceeds the *greater* of 15% of the estimated replacement cost after completion of all repairs, replacements, and improvements, or $6500 per unit adjusted by the local HUD Field Office high cost percentage for that area, *or*
2. Two or more major building components are being substantially replaced. Additions are permitted in substantial rehabilitation projects, but the costs for the additions of new units (not building component additions) are *not* included in the eligibility test.

D. Mortgage Term. The maximum term is 40 years or ¾ of the remaining economic life of the property.

E. Prepayment Restrictions. HUD permits prepayment restrictions in connection with the financing. (See Appendix.)

F. Cost certification. The mortgagor is required to submit a cost certification prepared by an independent public accountant upon completion of construction or substantial rehabilitation. The amount of mortgage that is finally endorsed for insurance by HUD after completion of construction can be reduced based upon HUD review of the cost certified amounts. The general contractor is also required to submit a cost certification if there is an identity of interest with the mortgagor. Identity of interest subcontractors are also required to cost certify.

G. Federal Labor Standards. The general contractor and any subcontractors are required to comply with federal wage and reporting requirements, including the payment of prevailing wage rates and the submission of weekly certified payroll reports (Prevailing wage schedules may be obtained from the HUD Field Office).

H. Liens/secondary financing. The National Housing Act requires HUD insured mortgages to be first liens. Secondary liens are permissible in the case of other HUD insured second mortgages (supplemental loans and operating loss loans) and other loans. (See Chapter 8 for complete details on secondary financing.)

I. Commercial space. Commercial facilities adequate to serve the needs of the project's occupants may be included. Commercial space is limited to 10% of the gross floor area of the project and commercial income is limited to 15% of gross income (higher percentages are permissible under section 220; see Section 3.7).

J. Military Impacted areas. HUD is prohibited from providing mortgage insurance in military impacted areas unless HUD determines that demand from nonmilitary households is sufficient to sustain occupancy in both the HUD-insured projects and the market as a whole. Section 238(c) of the National Housing Act authorizes insurance in military impacted areas upon certain findings by the Department of Defense and HUD Headquarters. Section 238(c) loans are not eligible for MAP review. In such areas, mortgagors should be encouraged to contact the Department of Defense for other potential programs administered by DOD which could provide other sources of financing for the proposed projects. Such projects can also be reviewed using the traditional HUD mortgage insurance review process under Section 238(c).

K. Student Housing. Projects financed with insured mortgages cannot be designed for student occupancy (e.g., 4 bedroom units with 4 baths.) Students and families are eligible occupants for family housing financed with mortgage insurance. However, project mortgages in college areas must be underwritten at comparable rents for family housing in the area. Loans cannot be underwritten with rental rates assuming multiple student occupants which would result in a processing rent higher than a typical family apartment.

L. Real estate requirements. The HUD insured mortgage must be on real estate:

1. held in fee simple, or
2. under a lease for not less than 99 years which is renewable beyond that; or
3. under a lease having a period of not less than 10 years to run from the maturity date of the mortgage.

M. Assurance of Completion. The mortgagor shall provide for assurance of completion of the project in forms approved by HUD.

1. For non-elevator or three story or less elevator buildings where the cost of construction or rehabilitation is more than $500,000, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD’s estimate of construction or rehabilitation cost including an imposed builder's profit on BSPRA transactions. As an option, HUD would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 15% of the HUD estimate of construction or rehabilitation cost.
2. For elevator buildings of 4 stories or more, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD’s estimate of construction or rehabilitation cost including an imposed builder's profit on BSPRA transactions.. As an option, HUD would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 25% of HUD’s estimate of construction or rehabilitation cost. The mortgagee may provide more stringent requirements.

3.5 Section 221(d)(4)

In addition to the general requirements in Sections 3.2, 3.3, and 3.4, the following requirements apply to Section 221(d)(4) projects:

A. Builder and Sponsor's Profit and Risk Allowance (BSPRA). The BSPRA allowance is used as a credit against the mortgagor's required equity contribution. To use BSPRA there must be an identity of interest between the mortgagor and general contractor. There is no builder profit contained in the mortgage calculation. For new construction, BSPRA is 10% of the estimated cost of on site improvements; structures; general requirements; general overhead; architect's fees; carrying charges and financing; legal, organizational and audit expenses (total of lines 50, 63 and 67), exclusive of land. For substantial rehabilitation BSPRA is no more than 10% of the above costs exclusive of the as is value of the existing structure.

B. Sponsor's Profit and Risk Allowance (SPRA). An amount included in replacement cost where no identity of interest exists between the general contractor and mortgagor. SPRA is no more than 10% of the total estimated cost of: architect's fees, carrying and financing charges, legal, organizational, and audit expenses.

C. Elderly Developments. Apartments specifically designed for the elderly (age 62 and over) are permitted as long as they do not contain the mandatory meals and services, central kitchens and dining areas, and non-shelter spaces associated with retirement service centers. No non-shelter services may be made a mandatory condition of occupancy. Charges for any optional services must be reviewed by the MAP Lender and approved by HUD for reasonableness. Institutional central kitchens are not permitted, nor may the project provide meal services on either a mandatory or optional basis. This prohibition does not preclude the installation of modest (non-luxury) equipment in a common use kitchen (for example, sink, stove, or refrigerator) in a non-shelter space for use of tenants or by outside entities providing catered meals.

D. Maximum mortgage limitations. In general, the maximum insurable mortgage is limited to the *lesser of*:

   1. 90% of HUD estimated replacement cost (new construction) or 90% of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation).
   2. A mortgage amount supported by 1.1 debt service coverage (90% of net income).
   3. Statutory per unit limitations, adjusted by the Field Office high cost percentage.

   (See Chapter 8 for complete details.)

3.6 Section 221(d)(3)

In addition to the general requirements in Sections 3.2, 3.3, and 3.4, the following requirements apply to Section 221(d)(3):

A. Nonprofit sponsor/mortgagors only. MAP review of Section 221(d)(3) insured loans is limited to nonprofit mortgagors, defined as corporations or associations organized for purposes other than profit or gain for itself or persons identified therewith and which HUD finds is in no way controlled by or under the direction or persons or firms seeking to derive profit or gain there from. Generally, such mortgagors are required to be chartered under Chapter 501(c)(3) of the Internal Revenue Code. HUD will review in detail the relationships between the nonprofit sponsor/mortgagor and profit motivated entities involved in the transaction. HUD will not insure Section 221(d)(3) transactions unless the nonprofit has the financial capacity and experience to own and operate the project successfully and is not under the direction or control of the profit motivated entities involved. A Headquarters review is required on all Section 221(d)(3) MAP and TAP firm commitment processing prior to the issuance of the firm commitment. The following documents must be submitted to the Office of Multifamily Development for review:

1. Form 3433, Request for Preliminary Determination of Eligibility as Nonprofit Sponsor/Mortgagor, and supplemental documents.

   a. Detailed explanation of motivation for sponsoring the project.

   b. A copy of the sponsor/mortgagor/s charger and bylaws or constitution as currently amended.

   c. Copy of current effect ruling from the Internal Revenue Service on sponsor/mortgagor’s tax exempt status. (Copy of any ruling denying tax exemption and or if a ruling is pending, explain the application’s legal and factual basis and current status).

   d. List of officers, directors or trustees of the sponsoring group/mortgagor including addresses and titles of positions and their social security numbers.

   e. Resumes on all principals and staff who will actively take part in the development of the proposed project.

   f. Current financial statement (balance sheet, profit and loss statement, and supporting schedules) as well as statements or the past 3 years if available.

   g. Signed written resolution of its directors or trustees, acknowledging the responsibilities and obligations of sponsorship and continuing ownership, and that this position reflects the will of the membership.

h. Form HUD-92013 Supp listing current bank and trade references for the sponsor, mortgagor, if formed and their officers (President, Vice President, Secretary, Treasury).

i. The information from the sponsor, mortgagor or any officer concerning prior Federal default or claim, if applicable.

j. Detailed statement of arrangements made or proposed for the following, (listing the principles involved, their relationship with the sponsor/mortgagor, the terms of the arrangements and a description of the circumstances surrounding each):

    1. land on which the project will be built

    2. Project construction, including selection of general contractor, subcontractors and architect.

    3. Legal and consulting services.

    4. Project financing, including any discounts.

2. Description of who is paying pre-development cost

3. Any proposed rent/income restrictions

4. Copy of Form FHA-2013, Application for Mortgage Insurance

5. Forms HUD-3434, Certificate of Relationships and Nonprofit Motives and HUD-3435, Certificate of Contractual Relationships.

6. Developers Agreement or any other document which shows the relationship and work responsibilities of all parties associated with the transaction.

7. Housing Consultant's Contract, if applicable.

8. Site control

9. Memorandum of Findings and Recommendations.

B. Elderly Developments. Apartments may be specifically designed for the elderly (age 62 and over) but may not contain the mandatory meals and services, central kitchens, dining areas, and non-shelter services associated with retirement service centers. No non-shelter services may be made a mandatory condition of occupancy. Charges for any optional services must be reviewed by the MAP Lender and approved by the Field Office for reasonableness.

Institutional central kitchens are not permitted, nor may the project provide meal services on either a mandatory or optional basis. This prohibition does not preclude the installation of modest (non-luxury) equipment in a common use kitchen (for example, sink, stove, or refrigerator) in a non-shelter space for use of tenants or by outside entities providing catered meals.

C. Maximum mortgage limitations. In general, the HUD maximum insurable mortgage is limited to *the lesser of*:

1. 100% of HUD estimated replacement cost (new construction) or 100% of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation).
2. A mortgage amount supported by 1.05 debt service coverage (95% of net income).
3. Statutory per unit limitations, adjusted by the Field Office high cost percentage. (See Chapter 8 for complete details.)

D. Prepayments. A 221(d)(3) mortgage with a nonprofit borrower cannot be prepaid in full without the prior approval of HUD.

3.7 Section 220

In addition to the general requirements in Sections 3.2, 3.3, and 3.4, the following requirements apply to Section 220:

A. Eligible areas. The property must be located in one of the following:

1. Existing slum clearance and urban redevelopment projects covered by a Federal aid contract before the effective date of the Housing Act of 1954.
2. An approved urban renewal area under Title I of the Housing Act of 1949.
3. Disaster urban renewal projects assisted under Section III of the Housing Act of 1949 as amended.
4. An area of concentrated code enforcement being carried out under Section 117 of the Housing Act of 1949.
5. A concentrated development area, approved by the HUD Field Office, in which concentrated housing, physical development and public service activities are being carried out in a coordinated manner, pursuant to a locally developed strategy for neighborhood improvement, conservation or preservation. The locally developed strategy shall:

   a. Provide for a combination of physical improvements, necessary public facilities and services, housing programs, private investment and citizen self-help activities appropriate to the needs of the area.

b. Coordinate public and private development efforts;

c. Provide sufficient resources to produce substantial long term improvements in the area within a reasonable amount of time, taking into account the severity of the area's problems.

B. Commercial Facilities. Commercial space may be included which is intended to serve the needs of the project residents and other residents of the area. Commercial space is limited to 20% of gross project area and commercial income to 30% of gross income.

C. Maximum mortgage limitations. In general, the HUD maximum insurable mortgage is limited to *the lesser of*:

1. 90% of HUD estimated replacement cost (new construction) and 90% of the sum of the HUD estimated cost of repairs and rehabilitation and the as is value of the property (substantial rehabilitation).

2. A mortgage amount supported by 1.1 debt service coverage (90% of net income).

3. Statutory per unit limits, adjusted by the Field Office high cost percentage. (See Chapter 8 for complete details.)

D. Builder/ Sponsor Profit and Risk Allowance (BSPRA). See definition of BSPRA in section 3.5 above.

E. Sponsor Profit and Risk Allowance (SPRA). See definition of SPRA in section 3.5 above.

F. Elderly Developments. Apartments specifically designed for the elderly and/or limited to elderly occupancy are *not* permitted under this section.

3.8 Acquisition/Refinancing of Existing Apartments - Section 223(f)

In addition to the general requirements in Section 3.2, the following requirements apply to Section 223(f) when used for acquisition or refinancing. (Any property acquired before the date of the mortgage insurance application shall be treated as a refinance transaction. Any property acquired after the date of the mortgage insurance application shall be treated as a purchase. In a purchase transaction, any identity of interest, however slight, between seller and purchaser requires the application to be processed as a refinance.)

A. Eligible Property. The property must contain at least 5 residential units with complete kitchens and baths, and have been completed or substantially rehabilitated for at least 3 years prior to the date of application for mortgage insurance. Properties that were constructed or substantially rehabilitated with HUD-insured multifamily mortgages that have been completed with the latent defects guarantee period expired, are exempt from the 3-year rule.

B. Ineligible properties.

1. Manufactured home parks are not eligible under this section.
2. Properties whose required repairs are so extensive that they meet the threshold for substantial rehabilitation are not eligible under this Section.

C. Repairs. Critical repairs must be performed prior to HUD endorsement of the mortgage. Non-critical repairs, approved by HUD, may be completed after endorsement with appropriate financial escrows at closing. Required repairs cannot be so extensive as to constitute substantial rehabilitation.

D. Elderly developments. Purchase or refinancing of existing apartments specifically designed for the elderly (age 62 and over) may be permitted under this program but may not contain the mandatory meals and services associated with retirement service centers. No non-shelter services can be a mandatory condition of occupancy and must be reviewed by the MAP Lender and approved by the Field Office for reasonableness. Non-shelter spaces already constructed for projects with current HUD-insured mortgages may include formal dining areas with meal services to be provided on an optional basis. Projects may provide modest kitchen equipment in a non-shelter space.

E. Prior Defaults/Claims. HUD does not prohibit applications for mortgage insurance for formerly HUD-held loans. However, HUD is not obligated to accept or process any mortgage insurance application with a borrower/principal who has not proven to be a good business partner. MAP Lenders should accept such applications only after they have considered and documented the economic, physical, operational, or management factors that led to the specific changes that have occurred which would justify new mortgage insurance. Early consultation with the field staff is strongly recommended since HUD will be very concerned with past experience of the loan and borrower/principal including Regulatory Agreement compliance.

F. Labor standards. Davis Bacon prevailing wage requirements do not apply to this program.

G. Insurance Upon Completion Only. HUD will insure only the permanent loan under this program.

H. Prepayment Provisions and Prohibition. The National Housing Act prohibits prepayment of loans insured under Section 223(f) for 5 years from the date of endorsement for insurance except where at the time of prepayment:

1. The mortgagor has entered into an agreement with HUD to maintain the property as rental housing for the remainder of the specified 5 year term;

2. HUD has determined that the conversion of the property to cooperative or condominium ownership is sponsored by a bona fide tenants organization representing the majority of households in the project;
3. HUD has determined that continuation of the property as rental housing is unnecessary to assure adequate rental housing for low and moderate income people in the community; or
4. HUD has determined that continuation of the property as rental housing would have an undesirable and deleterious effect on the community. (For specific prepayment provisions, see Appendix.)

I. Eligible Mortgagors. Both profit motivated and nonprofit borrowers are eligible mortgagors.

J. Ineligible Mortgagors. Condominium mortgagors are not eligible for this program.

K. Maximum mortgage limitations. In general the maximum mortgage limitations for the Section 223(f) program are as follows:

1. For a purchase transaction, *the lesser of* :
   a. 85% of HUD appraised value,
   c. 85% of acquisition cost,

   c. Section 207 statutory per unit limits, adjusted by the local Field Office high cost percentage for the locality, or
   d. A mortgage amount supported by 1.1765 debt coverage (85% of net income).
2. For a refinance transaction, *the lesser of:*
   a. 85% of HUD appraised value,
   b. Section 207 statutory per unit limits, adjusted by the local Field Office high cost percentage for the locality,
   c. A mortgage amount supported by 1.1765 debt coverage (85% of net income).
   d. The greater of the cost to refinance or 80% of HUD appraised value

(See Chapter 8 for complete details.)

L. Reserve for Replacements. HUD requires deposits to the Reserve for Replacements. (See Chapter 7 for the actual calculations.)

M. Secondary financing. HUD permits secondary financing on section 223(f) loans under certain conditions. (See Chapter 8 for complete details.)

N. Commercial space. Commercial area shall not exceed 20% of the total net rentable area of the project and commercial income shall not exceed 20% of effective gross income.

O. Real estate requirements. The mortgage shall be on real estate held:

1. in fee simple; or
2. under a lease for not less than 99 years which is renewable; or
3. under a lease executed by a lessor approved by HUD with a minimum term of 50 years from the date the mortgage is executed.

P. Mortgage Term. The maximum term of the mortgage is 35 years or ¾ of the remaining economic life of the property.

Q. Firm Commitment Processing Only. There is no preapplication submission for Section 223(f) applications. Preliminary inquires with the HUD staff are encouraged if there are concerns about marketability, environment or competing proposals.

3.9 Section 232 Health Care Requirements

In addition to the general requirements for HUD insured loans in Section 3.2, the following provisions apply to Section 232 projects.

A. Eligible Facilities. MAP Lenders can submit requests for pre-application review and Firm Commitment applications for the following types of facilities:

1. Nursing Home.
   a. A public facility, proprietary facility, or facility of a private nonprofit corporation or association, which consists of at least 20 beds and is licensed or regulated by the State municipality or other political subdivision in which the facility is located.
   b. Provides for the accommodation of convalescents or other persons who are not acutely ill and not in need of hospital care, but who require skilled nursing care and related medical services including past hospital care (sub-acute).
   c. Corresponds to the Department of Health and Human Services "Skilled Nursing Facility" (SNF).
2. Intermediate Care Facility.
   a. A proprietary residential facility or facility of a private nonprofit corporation or association which consists of at least 20 beds and is licensed or regulated by the State, the municipality or other political subdivision in which the facility is located.

b. Provides for the accommodation of persons who require minimum but continuous care (24-hour staffing/supervision) but are not in need of continuous medical or nursing services.

c. Corresponds to the Department of Health and Human Services "Intermediate Care Facility"(ICF).

3. Board and Care Home.

a. Board and Care Homes are known by many different names in different states, including domicilliary care, shelter care, adult congregate living facility, personal care, etc. HUD's definition is as follows:

(1) a proprietary residential facility or a residential facility owned by a private nonprofit corporation or association which consists of at least 5 accommodations, bedrooms with a maximum of 4 persons for each accommodation, each with a full bath. Group dining facilities must be available.

(2) provides room, board and continuous protective oversight. "Continuous protective oversight" must include the availability of both scheduled and unscheduled assistance for defined special needs of the occupants on a 24 hour basis and involve a range of activities or services such as:

(a) For relatively independent occupants, awareness by management and staff of the occupants' conditions and whereabouts as well as the availability of assistance for the occupants as needed; or

(b) For relatively dependent occupants, supervision of nutrition and medication with assistance for the activities of daily living bathing, dressing, shopping, eating and continuous responsibility for the occupant’s welfare. There is no minimum requirement for activities of daily living.

(c) "Continuous protective oversight" is not limited to the above activities nor must it include the examples given.

(3) Must be a freestanding structure or an identifiable and separate portion of an intermediate care facility or nursing home.

(4) Intermediate care or nursing services may not be carried out in a board and care facility or the board and care portion of a residential care facility. However, to accommodate a couple, a board and care resident may reside in the nursing/intermediate care area. A resident may contract with a home health agency for nursing and personal care services.

(5) Must provide areas for central dining, kitchen (or preparation area where food is supplied from an offsite location), lounges, recreation, and other multipurpose rooms. Where food is provided from an offsite location, the preparation area in the facility must be of sufficient size to allow for the installation of a full kitchen if it becomes necessary, or additional land must be available to add kitchen space.

(6) Must offer three meals per day to each resident.

(a) Residents in accommodations without kitchens must take the three meals a day provided by the facility.

(b) Residents whose accommodations have a kitchen must take at least one meal a day provided by the facility.

(7) Charges may be assessed for providing other services that are in addition to those services included in the basic residential fee. Such services may include housekeeping, laundry, supervision of nutrition or medication and assistance with daily living (bathing, dressing, shopping, eating).

(8) Must be regulated by the State in accordance with Section 1616(e) of the Social Security Act (Keys Amendment) and meet the State's eligibility requirements. The State also must have certified to HUD that it is in compliance with the provisions of 1616(e).

b. Limitations on Independent Living Units

(1) May not exceed 25 percent of the total projected number of beds or units in any board and care project.

(2) Required Reserves and Escrows. A board and care project with independent living units (efficiency or one-bedroom units with complete kitchen and bath facilities) requires a 12-month debt service reserve in addition to any operating deficit.

(a) Operating Deficit Escrow. Must:

(i) Cover the period between construction completion and the time HUD and the MAP Lender estimate sustaining occupancy will be reached.

(ii) Be held until sustaining occupancy has been reached and maintained for 90 days thereafter.

(b) Debt Service Reserve. Must be required for any independent living units. Any combination of independent living units with a nursing home/intermediate care facility or a board and care facility requires a prorated debt service reserve (for example, 25 percent independent living units would require 25 percent of the 12-month debt service reserve for the portion of the project used as a board and care facility).

(c) Establishment of the operating deficit escrow and debt service reserve must be provided at initial endorsement either by:

(i) Agreement of sponsors to furnish additional funds and bond guaranteeing sponsor's performance (Forms FHA-2476 and 2477).

(ii) Escrow Agreement – Additional Contribution by Sponsors (Form HUD-92476A).

(d) Disbursement. When both an operating deficit escrow and debt service reserve is required, disburse first from the escrow and then from the reserve to fund operating expenses, debt service payments, initial marketing and rent-up costs, etc.

4. Assisted Living Facility.

   a. A proprietary, public or nonprofit facility of at least 5 residential units (not to exceed 4 persons per unit or per bathroom) which is designed for frail elderly (62 years or older) persons who need assistance with at least 3 activities of daily living. Activities of daily living include such things as bathing, dressing, eating, getting in or out of beds and chairs, walking, going outdoors, using the toilet, preparing meals, shopping for personal items, obtaining and taking medications, managing money, using the telephone or performing light housework. Residents may make their own arrangements for support services, such as physical therapy, nursing care, podiatry, etc. Residents may employ their own private staff to provide assistance with activities of daily living or other household/personal needs. However, the facility is still responsible for the residents' continuous protective oversight. A resident may have a contract with a home health agency for nursing and personal care services.

   b. Must provide areas for central dining, kitchen (or preparation area where food is supplied from an offsite location), lounges, recreation, and other multi-purpose rooms. Where food is provided from an offsite location, the preparation area in the facility must be of sufficient size to allow for the installation of a full kitchen if it becomes necessary, or additional land must be available to add kitchen space.

   c. Must provide room, board, and continuous protective oversight. This involves a range of activities and services that may include such things as awareness by management and staff of the occupants' condition and location as well as the ability to intervene in a crisis for dependent and relatively independent occupants on a 24-hour basis.

      (1) For independent occupants: awareness by management and staff of the occupants' condition and whereabouts as well as the availability of assistance for the occupants as needed; or

      (2) For dependent occupants: supervision of nutrition, assistance with medication, and continuous responsibility for the occupants' welfare.

   d. Assisted living facilities must offer three meals per day to each resident.

      (1) Residents in accommodations without kitchens must take three meals a day provided by the facility.

      (2) Residents whose accommodations have a kitchen must take at least one meal a day provided by the facility.

   e. Assisted living facilities may need to cater to the special needs of residents depending on their condition or diagnosis such as Alzheimer's disease. If serving those needs, the design/environment of such facilities must accommodate those requirements in, for example, dementia special care units.

f. The assisted living facility's admission agreement must state that no dwelling unit in the facility will be occupied by more than one person without the consent of the other residents of that unit. The resident who signs the admission agreement will be the occupant of that dwelling unit and must meet the definition of frail elderly. The resident who signed the admission agreement must consent before another person(s) may occupy the unit.

5. Day Care. An eligible health care facility may provide nonresidential (outpatient) care for elderly individuals and others (e.g., persons with physical or mental disabilities) who require care during the day. A facility that contains *only* a day care component is *not* eligible under Section 232. Nonresident day care space may not exceed 20% of the gross floor area of the facility and nonresident day care income may not exceed 20% of gross income. Day care space at a separate site must have adequate toilet, bathing and cooking facilities and adequate transportation for its clients. A day care facility must meet the minimum requirements of any third party reimbursement agency. The mortgagor must provide a CoN (Certificate of Need) or operating license if required by State or local law and demonstrate that the day care space will be self-supporting.

B. State Approvals. The following approvals are required to be submitted at the pre-application stage:

1. Certificate of Need. Skilled nursing care and intermediate care beds require a certificate of need (CoN) from the state agency with jurisdiction. (See Forms Appendix).

2. If no authorized State agency exists, or if it is not empowered to execute a CoN, the State may conduct or commission an independent study of market need and feasibility acceptable to HUD that:

a. meets the standards of the American Institute of Certified public Accountants, as certified by the State and/or preparer of the market study,

b. assesses market need on a market wide basis, including excess beds and typical market wide operating occupancy rates of existing facilities,

c. discusses the impact of the proposed project on other health care facilities and services in the area,

d. provides demographic projections (size, density, distribution and vital statistics on household income) for the proposed project and market area,

e. discusses available alternative health care delivery systems (geriatric day care, board and care, etc.),

f. describes the reimbursement structure or payment sources of the proposed project and that of the competing projects in the area, including percentage of self-pay clients and daily cost to the client; percentage of Medicaid/Medicare clients and reimbursement rate; percentage of other clients (managed care, etc.).

g. estimates market absorption period of beds in the proposed project by month including discussion of market supply, market reaction to unit type (private, semi-private, 3-bed, etc.) and resident turnover.

3. If the State is not authorized to conduct, commission or certify the study as to form and substance, the MAP Lender must provide financial and market information acceptable to HUD.
4. The proposed mortgagor may reimburse the State for the cost of the independent market and feasibility study.
5. Exception from market study for certain small facilities. For small intermediate care facilities for the mentally retarded or developmentally disabled for less than 50 individuals, the State agency responsible for licensing, certifying, financing or monitoring the project may provide HUD with a written statement of the need for the project instead of the independent study of market need and feasibility.
6. Substantial Rehabilitation. If the authorized State agency requires a new CoN, a new certification on Form 2576-HF must be submitted. If the authorized State agency does not require a new CoN, the MAP Lender must provide a statement from the State agency that a new CoN is not required and a copy of the original CoN. If there is no authorized State agency and the rehabilitation involves new beds, the alternative market study described above must be submitted.
7. Acquisition or Refinancing. If the authorized State agency requires a new CoN, a new certification on HUD form 2576-HF must be submitted. If the authorized State agency does not require a new CoN, a statement from the state agency and the original CoN must be submitted.
8. Bed authority modifications. Any proposed modifications (additions, deletions or major improvements) in the bed authority for any Section 232 facility must receive prior Field Office approval in order to protect HUD's security interest.
9. If the State requires a CoN for assisted living or board and care facilities, the Lender must submit a copy to HUD.

C. Licensing. Any Section 232 facility must be regulated by the State, municipality, or political subdivision in which the facility is or is to be located and the appropriate agency for such jurisdiction must provide a license or certificate that the facility complies with the applicable State or local standards and requirements for such facilities, including issues of staffing, occupancy, etc.

D. Liability Insurance. HUD requires health care facilities to maintain liability insurance, failure to do so is a technical default under the terms and conditions of the mortgage insurance contract. When mortgage underwriting is performed by HUD [MAP Lender], the current prevailing premium rates in that State, at a minimum, must be used along with reasonable deductible levels, and adequate coverage levels.

E. Ineligible facilities. *The following are not eligible under section 232:*

1. Facilities that charge "founders fees", "life care fees" or similar charges.

2. Facilities not meeting program intent such as hospitals, clinics, diagnostic and treatment centers, group practice facilities, and halfway houses. (Residential care facilities may include clinics, medical offices and similar related services as commercial space).
3. Facilities not providing the continuous protective oversight or minimum assistance required, such as retirement homes, boarding houses or single room occupancy residences that provide only food and shelter.

F. Bankruptcy. Any owner or operator of a healthcare facility or their affiliate or renamed or reformulated company that has file for, is in, or has emerged from bankruptcy within the last five years is not eligible to participate in any manner in a facility which is the subject of a mortgage insured through the Section 232 Mortgage Insurance for Health Care Facilities Programs. A project in bankruptcy that is acquired by a non-identity-of-interest owner in good standing is eligible for mortgage insurance. **Any exception to this requirement must be approved by HUD Headquarters.**

G. Leased Facilities/Regulatory Agreement. Section 232 mortgagors are permitted to lease facilities to qualified operators with prior written HUD approval. The lessee must execute the Regulatory Agreement, Form HUD 92266 NHL. The MAP Lender must determine that:

1. The lease agreement contains a restriction against its assignment without HUD prior approval and does not conflict with Section 232 program requirements,
2. The lease payments are sufficient to properly maintain the project, enable the lessor to meet debt service requirements and other operating expenses and are comparable to other leases in the market,
3. The lease requires prior written approval by HUD for any modification in bed authority.
4. Nonprofit mortgagors can lease their facilities only to other nonprofits.
5. Failure to disclose a lease arrangement or identity of interest between mortgagor and lessee are grounds for HUD sanctions. A provision must be incorporated into the regulatory agreement that any and all future lessees must execute the regulatory agreement and that the lessee is required to submit financial statements to HUD within 60 days of the close of the project's fiscal year.
6. The lessee shall have the responsibility to seek State licensure and a provider agreement for Medicaid and Medicare residents if the facility has a dual certification. A copy of the provider agreement must be submitted to HUD.
7. The mortgagor/lessor must ensure that the facility meets State licensure and standards.

H. Commercial area limitations under Section 232.

Commercial space and income limitations. Any commercial activity must be compatible with the use of the facility. Day care space is not considered commercial space. See Sections 3.10 and 3.11 below for New Construction/Substantial Rehabilitation and Acquisition /Refinancing commercial area limitations.

I. Eligible mortgagors. The following are eligible mortgagors under Section 232:

1. Proprietary mortgagor. A proprietary mortgagor is a corporation, trust, partnership, individual or other qualified legal entity that is profit motivated.

2. Nonprofit mortgagor. A nonprofit mortgagor is a corporation or association organized for purposes other than profit or gain for itself or persons identified therewith that HUD finds is no way controlled by or under the direction of persons or firms seeking to derive profit or gain therefrom. Generally, such a mortgagor must be chartered under Chapter 501(c)(3) of the Internal Revenue Code.

3. Public mortgagor (Nursing homes only). A public mortgagor is a Federal or State instrumentality, a municipal corporate instrumentality of one or more States or a redevelopment or housing corporation formed under and restricted by Federal or State laws or regulations of a State banking or insurance department as to charges, capital structure, rate of return or methods of operation.

J. Sinking Fund. HUD requires establishment of a sinking fund for nursing homes in States that:

1. Include the capital component (depreciation and interest) in the Medicaid reimbursement for nursing homes and

2. Use a pass-through method of paying the provider for the depreciation (straight line depreciation) on the assets.

The sinking fund captures the excess capital in the early years of the mortgage and sets aside monies (per the mortgagee schedule) in a separate fund account to pay the principal payment to offset shortfalls in the later years' capital investment.

K. Funding Sources. Assisted living is primarily a private pay market. However, different States may have funding sources such as Medicaid or a State Supplemental Security Income (SSI) matching program.

L. Liens/Secondary Financing. HUD is required by law to have a first lien position. Secondary loans are permissible in the case of other HUD-insured second mortgages (supplemental loans and operating loss loans) and other loans. (See Chapter 8 for complete details on secondary financing.)

M. Real estate requirements. The mortgage shall be on real estate held:

1. In fee simple; or

2. Under a lease for not less than 99 years which is renewable or having a period of at least 10 years beyond the maturity date of the mortgage.

N. Line of Credit Financing.

1. HUD will recognize line-of-credit portfolio indebtedness attributable to acquisition costs, repairs and capital improvements.

2. The mortgagee must obtain a letter from the issuer of the line-of-credit listing each facility encumbered by the financing and the dollar amount needed for each facility to obtain a partial release from the financing. Absent the partial release information, the following are acceptable alternatives:

   a. Option One. HUD will divide the line-of-credit debt by the total number of beds in the facilities to come up with the per bed debt.

   b. Option Two. Based on MAP appraisals for all the facilities, HUD will add up the approved values for all the facilities. HUD will divide the line-of-credit debt by the sum of the values. Multiply the result by a facility's value to determine the amount of existing indebtedness to be assigned to a facility.

   Note: Lenders may develop other options for assigning debt. HQ will review and approve these options on a case-by-case basis.

O. Real Estate Investment Trusts (REITs).

Some REITs have purchased health care facilities with cash raised from the sale of shares in the REIT. Historically, HUD has recognized that special circumstances may exist from time to time when dealing with REITs. In this case, we will treat the cash payment for the facility in the same manner as line-of-credit financing with the following exceptions.

a. The REIT must submit from the independent certified public accountant a report of the cash payment made for each facility.

b. An authorized officer of the REIT signs and dates a cover letter to HUD attesting the accuracy of the report. Said letter must contain the 1010 Criminal warning.

c. HUD will recognize 75% of the cash payment as equivalent to existing debt.

3.10 Section 232 - New Construction/Substantial Rehabilitation

Requirements: HUD can insure loans to cover both the construction and permanent loans (Insurance of Advances) or just the permanent loan (Insurance upon Completion).

A. New construction. A facility qualifies as new construction when all project and construction elements are installed as part of the construction contract and no work has been done prior to the issuance of the HUD Firm Commitment.

   1. Work can begin after issuance of a HUD Firm Commitment with specific approval case-by-case from the HUD Field Office using the Early Construction Start process.

   2. Construction may not start on Insurance Upon Completion projects until issuance of a Firm Commitment.

B. Substantial rehabilitation. A facility qualifies as substantial rehabilitation when:

1. The hard costs of repairs, replacements and improvements (including major movable equipment eligible for inclusion in the mortgage) and additions exceeds 15% of the project's value after completion of all repairs, replacements, improvements and additions, or

2. Two or more major building components are being substantially replaced. Additions are permitted in substantial rehabilitation projects, but the costs for the additions are *not* included in the eligibility test. Building additions combined with refinancing of an existing structure should be processed as a new construction, blended rate 232/223f application unless the work proposed on the existing facility meets the criteria for substantial rehabilitation on it's own without considering the costs of the new addition.

C. Maximum mortgage limitations. In general the HUD maximum insurable mortgage is limited to the *lesser of:*

1. 90% of HUD appraised value, including major movable equipment (95% for nonprofit mortgagors).

2. mortgage amount supported by 1.11 debt coverage (90% of net income); 1.05 for nonprofit mortgagors (95% of net income). (See Chapter 8 for additional limits for substantial rehabilitation loans and complete details.)

D. Mortgage term. The maximum mortgage term is 40 years or ¾ of the remaining useful life of the property.

E. Cost certification. The mortgagor is required to submit a cost certification prepared by an independent public accountant upon completion of construction or substantial rehabilitation. The amount of mortgage that is finally endorsed for insurance by HUD after completion of construction can be reduced based upon HUD review of the cost certified amounts. HUD approved cost certified amounts may qualify for a mortgage increase under specific conditions. The general contractor is required to submit a cost certification where a cost plus form of construction contract is used. Subcontractors with an identity of interest with the mortgagor or general contractor are also required to cost certify. (See Chapter 14 for complete details.)

F. Federal Labor standards. The general contractor and all subcontractors are required to comply with federal wage and reporting requirements, including the payment of Davis Bacon prevailing wages and the submission of weekly certified payroll reports. (Prevailing wage schedules may be obtained from HUD.)

G. Assurance of Completion. The mortgagor shall provide for assurance of completion of the project in forms approved by HUD.

1. For non-elevator or three story or less elevator buildings where the cost of construction or rehabilitation is more than $500,000, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD's estimate of construction or rehabilitation cost. As an option, HUD would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 15% of the HUD estimate of construction or rehabilitation cost.

2. For elevator buildings of 4 stories or more, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD's estimate of construction or rehabilitation cost. As an option, HUD would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 25% of HUD's estimate of construction or rehabilitation cost. The mortgagee may provide more stringent requirements.

H. Medicaid/Medicare Rule. Medicaid rates, regardless of the composition of the project's actual or proposed occupancy, will be used to establish the income estimate for 67% of nursing home/intermediate care beds. Medicare rates will be used for 3% of the beds. This restriction does not currently apply to board and care or assisted living facilities.

I. Commercial Space and Income Limitations. New Construction/Substantial Rehabilitation is equivalent to 10 percent of the gross floor area of the project and 15 percent of the gross project income; commercial space that is intended to exclusively serve the residents of the facility is not counted toward the 10 percent limit.

3.11 Section 232/223(f) - Acquisition/Refinancing

The major requirements for Section 232/223(f) Projects for acquisition or refinancing are as follows: (Any property acquired before the date of the mortgage insurance application shall be treated as a refinance transaction. Any property acquired after the date of the mortgage insurance application shall be treated as a purchase. In a purchase transaction, any identity of interest, however slight, between seller and purchaser requires the application to be processed as a refinance.)

A. Property eligibility. The facility must have been completed or substantially rehabilitated for at least three years prior to the date of the Firm Commitment application. Projects with additions completed less than 3 years previous are eligible as long as the addition was not larger than the original project in size and number of beds.

B. Ineligible facilities. Facilities requiring a level of repairs which constitutes substantial rehabilitation as defined in section 3.10 above are not eligible for mortgage insurance under this section.

C. Insurance upon completion. HUD will only insure the permanent loan under this program if all critical repairs are completed before HUD endorsement of the mortgage.

D. Delayed completion of repairs. HUD permits completion of **non-critical** repairs after endorsement for insurance with appropriate financial guarantees. (See Chapter 12 for complete details).

E. Davis Bacon Labor standards. To be eligible under this section, the level of required repairs cannot meet the standard for substantial rehabilitation. Therefore, the prevailing wage requirements of the Department of Labor do not apply to this program.

F. Mortgage insurance premium. The HUD mortgage insurance premium is 1% of the mortgage amount for the first year, payable at endorsement of the mortgage, and .5% of the average outstanding principal balance thereafter. (See 24 CFR 207.252.)

G. Maximum mortgage limitations. The maximum insurable mortgage is:

1. For Purchase Transactions, the lesser of:
   a. 85 % of HUD appraised value (90% for nonprofit mortgagors).
   b. A mortgage amount supported by 1.1765 debt coverage (85% of net income); 1.11 for nonprofit mortgagors (90% of net income).
   c. 85% of acquisition cost (90% for nonprofit mortgagors).
2. For Refinance Transactions, the lesser of:
   a. 85% of HUD appraised value (90% for nonprofit mortgagors).
   b. A mortgage amount supported by 1.1765 debt coverage (85% of net income); 1.11 for nonprofit mortgagors (90% of net income).
   c. The cost to refinance the existing debt.

(See Chapter 8 for complete details.)

H. Cost certification. The mortgagor must certify the actual costs incurred in the acquisition or refinancing of the property.

I. Mortgage Term. The term of the mortgage cannot exceed 35 years or ¾ of the remaining economic life of the physical improvements.

J. No Equity Take-Out. Borrowers may not receive any cash proceeds from the refinance of the mortgage under Section 232/223(f). The sole purpose for the program is for owners to refinance at lower interest rates, reduce debt service requirements, and make needed repairs.

K. Medicaid/Medicare Rates. The income estimate should be based on the percentage of Medicaid/Medicare beds shown on the last 3 years of financial statements.

L. Firm Commitment Processing Only. There is no preapplication submission for Section 223(f) applications. Preliminary inquires with the HUD staff are encouraged if there are concerns about marketability, environment or competing proposals.

M. Commercial Space and Income Limitations. Refinancing Existing (232/223(f)) is equivalent to 20 percent of the total net rentable area of the project and 20 percent of the effective gross project income.

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