

## CHAPTER 4. MORTGAGE CREDIT PROCEDURES

- 4-1. GENERAL. Mortgage Credit analysis is to be completed as prescribed in HUD Handbook 4155.1 - Mortgage Credit Analysis for Mortgage Insurance on One-to Four-Family Properties, except as modified in this Chapter. Mortgagors must have sufficient assets to close the loan and to maintain the mortgage payments during rehabilitation. The Section 203(k) insured loan is part of the General Insurance Fund, therefore, the Mortgage Insurance Premium is paid monthly.
- 4-2. VALUE OF THE PROPERTY. The value of the property is either the as-is value plus the cost of rehabilitation, or 110 percent of the value after rehabilitation, whichever is less. The Conditional Commitment/Statement of Appraised Value (Form HUD 92800.5B) reflects the lesser of the two values (refer to paragraph 2-4.A.).
- 4-3. ACQUISITION COST. The acquisition cost includes the following:
- A. The purchase price of the property, or the existing debt in cases involving refinancing.
  - B. The cost incidental to closing the transaction.
  - C. HUD's accepted rehabilitation cost estimate. This figure represents the proposed improvement and any required repairs, including the cost of rehabilitation described in paragraphs 1-10.B. and 1-13).
- 4-4. MAXIMUM MORTGAGE AMOUNT. Refer to paragraph 1-10.
- 4-5. INVESTORS USING THE ESCROW COMMITMENT PROCEDURE. A mortgagor purchasing investment property will not be eligible for an insured 203(k) mortgage unless the lender is satisfied that the mortgagor has the ability to support the mortgage payments, complete the rehabilitation and rent or lease the properties within 12 months of completion of rehabilitation. Lease agreement(s) prior to closing are not required. On properties with two-to-four units, income analysis should include the projected rents for the subject property.

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- 4-6. 7-UNIT LIMITATION. A Borrower that purchases property for rental purposes rather than rehabilitation and sale, will be subject to the 7-unit limitation in 24 CFR 203.42.

An investor should not be allowed to rapidly accumulate FHA insured properties that clearly and collectively constitute a multifamily project. Only under very specific conditions should a field office allow a mortgagor to have a financial interest in eight or more rental units. A field office can allow more than seven (7) units in a contiguous area under the following specific conditions:

- The neighborhood has been targeted by a State or local government for redevelopment or revitalization; and
- The State or local government has approved, and submitted the following to the field office: (1) A plan describing its program of neighborhood redevelopment and revitalization; (2) The geographic area targeted for redevelopment; and (3) The nature and proportion of public and/or private commitments that have been made in support of the redevelopment program. These commitments should include programs to expand homeownership and affordable housing opportunities and help create jobs and promote economic development of the area. The Plan can include, for example, the use of Section 8 rent subsidies, redevelopment grants, and interest rate buydowns for homeowner-occupants.

If certain geographic areas are targeted for comprehensive community, housing, or economic development assistance, such areas should be defined with maps, so as to demonstrate that the subject property is located in a targeted area. Through legislation, States frequently define and recognize such areas as Community Redevelopment Areas (CRA's) or Enterprise Zones. Communities may also have taken official action, independently or with the support of State legislation, to designate targeted geographic areas as redevelopment areas as well. Evidence (legal documentation, such as resolutions or ordinances) should be obtained from the appropriate jurisdiction indicating the official approval (by the Chief Elected Officials), or adoption of such areas along with

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evidence that such areas are currently still recognized and actually treated as targeted areas.

Funding and actual expenditures demonstrate the sincerity of the State or local government's commitment to the target area. It is advisable to ask for a "Sources and Uses" type statement or expenditures summary statement from the applicable jurisdiction that clearly demonstrates the expenditures to date, as well as any planned expenditures, by type of activity (e.g., public improvements, housing improvements, or economic development) for that targeted area for the subject property. Ideally, the information provided should be sufficient to fully demonstrate an ongoing commitment (past, present, and future). Future commitment is applicable if the targeted area is still officially recognized as an area with need for certain public support or assistance. A supporting document that large communities can provide as additional evidence of the expenditures in certain targeted areas is the CDBG (Community Development Block Grant) Grantee Performance Report. This report is limited to CDBG funded activities only. However, for some targeted areas this may be the only funding available.

Exceptions to the seven (7) unit requirement should be made only where the property is located in an area that is reasonably viable and there is a demonstrated need in the area for adequate rental housing for families of low and moderate income. Appraisers should be trained to monitor vacancies and absorption of units in rental dominated neighborhoods.

- 4-7. REFINANCING. Although Section 203(k) may be used to refinance and rehabilitate a property, it may not be used as a means of withdrawing or recapturing equity, and thus, no cash back to an investor mortgagor is permitted. It is essential that any existing debt or obligation(s) be clearly limited to the property to be rehabilitated. A line of credit made available to the refinancing mortgagor without a clear connection to the subject property does not meet HUD requirements unless there is documentation, acceptable to the Secretary, indicating loan proceeds were used for the purchase and/or repair of the

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property. The same is true for any first mortgage or other junior liens secured by the property for at least one year prior to loan application.

The maximum mortgage amount allowed is limited to the lesser of: (1) The sum of the existing principal balance, costs of rehabilitation, non-recurring closing costs, and reasonable discount points, or (2) The sum of the As-Is Value (or the acquisition cost if owned less than one year from the date of application, whichever is less), the cost of rehabilitation, non-recurring closing costs and reasonable discount points.

Refer to the Maximum Mortgage Worksheet. in Appendix 11. Additional information is contained in paragraph 1-10.

- 4-8. FIRM COMMITMENT. Complete Form HUD 92700, Section 203(k) Maximum Mortgage Worksheet (Appendix 11), to determine the maximum insurable mortgage amount; make this form a part of the firm commitment. In addition, Form HUD-92900WS (Mortgage Credit Analysis Worksheet) is used to determine the mortgagor's required cash investment and credit worthiness. However, since the Form HUD 92700 is used for mortgage calculation purposes, the maximum mortgage calculation section of the Mortgage Credit Analysis Worksheet (Form HUD 9290WS) should be left blank. Attach Form HUD 92700 to the firm commitment upon issuing to the mortgagor.

On Form HUD-92900, Application for Commitment for Insurance Under the National Housing Act, the lender enters the total for the alterations, improvements and repairs as part of the computation of the acquisition cost. Itemize the discounts and origination fee components of the cost of the rehabilitation on the application.

Either HUD or a DE Underwriter will review the application and, if acceptable, issue the appropriate Certificate of Commitment.

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- 4-9. MORTGAGE LOAN CLOSING. Prepare the Rehabilitation Loan Agreement. The agreement establishes the conditions under which the lender is to release funds from the Rehabilitation Escrow Account.

At loan closing, the mortgage proceeds disbursed by the lender and the cash from the borrower must equal the total cost of acquisition or refinance. The lender must establish the Rehabilitation Escrow Account and place in the account the total amount to finance the construction, plus the contingency reserve, inspection fees and any mortgage payments, where applicable.

Following closing, the borrower is required to begin making monthly mortgage payments on the entire principal amount of the mortgage, including the amount in the Rehabilitation Escrow Account, which has not yet been disbursed, according to the same guidelines as a 203(b) insured loan.

If the construction is partially or fully completed, a Draw Inspection cannot occur for at least one day following the closing of the loan. Release of monies in the Rehabilitation Escrow Account at closing is not allowed except for the allowable fees designated in paragraph 5-2.C.1).

The borrower must to obtain all licenses and/or permits that are required by local governmental authorities. Draws releases cannot be given until the field office or DE Underwriter is assured that these requirements have been satisfied and the fees paid.

- 4-10. DEBT SERVICE REQUIREMENTS. All three- and four-unit properties, investor-owned as well as owner-occupied, must be self-sustaining (i.e., the net rent from all units must equal or exceed the monthly debt service). The debt service ratio is computed by dividing the monthly mortgage payment (PITI) by the net rental income from all units and may not exceed 100 percent. The net rent is calculated using all units, even if one unit is to be occupied by the mortgagor(s).

"Net Rental" is defined as HUD's estimate of after-improved market rent for the property less an allowance for vacancy and collections.

For 203(k) insured loans, the additional requirements of three months debt service in reserve following closing does not apply where the loan contains a monthly mortgage payment reserve (paragraph 1-9.G.), except when using the Escrow Commitment Procedure (see paragraph 4-5).

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