




U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

JUN 26 2006

MEMORANDUM FOR: ALL MULTIFAMILY HUB AND PROGRAM CENTER  
DIRECTORS

FROM:   
Charles H. Williams, Deputy Assistant Secretary, Office of  
Multifamily Housing Programs

SUBJECT: Processing of Section 221(d) Substantial Rehabilitation for OAHP  
Full Restructuring Transactions

The purpose of this memorandum is to notify FHA field staff of procedures for processing of applications for FHA mortgage insurance under Section 221(d)(3) or 221(d)(4), Substantial Rehabilitation, on projects that have been or are undergoing full restructure by the Office of Affordable Housing Preservation (OAHP). These instructions are effective immediately.

The Office of Affordable Housing Preservation (OAHP) is responsible for restructuring multifamily mortgages under the Mark-to-Market (M2M) Program. In preserving HUD's affordable housing stock, OAHP's M2M underwriting determines market rents, project replacement and rehabilitation needs, project income and expenses and the amount of the new first, second and third mortgages needed to facilitate the restructured project.

OAHP utilizes underwriting procedures including, but not limited to, outstanding Section 223(a)(7) instructions. OAHP is authorized to commit on a Section 223(a)(7) loan through a Memorandum of Understanding between OAHP and the Office of Multifamily Development dated February 28, 2001.

The Office of Multifamily Housing recognizes that transactions being fully restructured by OAHP may seek a new first mortgage under Section 221. Working cooperatively with OAHP, the local Multifamily Hub or Program Center with jurisdiction will process applications for Section 221 in accordance with outstanding Multifamily Accelerated Processing (MAP) and Traditional Application Processing (TAP) instructions with the exceptions listed below. The primary goal of these procedures is to facilitate cohesive processing of these applications that does not compromise Section 221 requirements. Headquarters anticipates and encourages frequent communication between OAHP and the Office of Housing. While close communication with OAHP is required throughout the Section 221 processing, Hub and Program Centers must continue to work with the Lender.

1. The Lender must officially notify HUD of the outcome of the OAHP process in the “Narrative Description of the Project”. The notification must include, but is not limited to, OAHP’s estimate of first mortgage amount, scope and cost of repairs, market rents, exception rents, operating expenses and sources and uses, including second and third loan requirements.
2. When use of exception rents is requested, OAHP must provide a statement authorizing the use of exception rents with the amount of the rents.
3. In accordance with MAP Guide Chapter 11.2.L. Waivers, Hub and Program Center Offices are reminded that pre-application and Firm Commitment submission requirements under Section 221 Substantial Rehabilitation must be adhered to and waiver of exhibits is not permitted. For example, joint inspections, work write-ups, construction contracts, and HUD-3433, Request for Preliminary Determination as Nonprofit Sponsor and/or Mortgagor and supplemental documentation, must be completed and/or submitted for the Section 221 processing.
4. The Lender may submit for review, third party reports and other processing materials included in the OAHP processing. However, the local Hub or Program Center may, at its own discretion, use these documents as resource material, to be used in support, only, of normal Section 221 processing. For example:
  - a. Physical Condition Assessment (PCA). The PCA completed for OAHP’s purposes may not be as detailed as the physical needs and cost analysis required under the MAP Guide for Section 221 processing. The report may, however, be reviewed by the FHA cost analyst who may determine that certain repairs and specified cost are acceptable for use in processing the Section 221 mortgage.
  - b. Limited Scope Appraisal. Under Section 221 processing, the value of the land and/or the “as-is” value are required. The limited scope appraisal prepared for OAHP purposes may include recent land sales that may be helpful in completing the valuation required under Section 221.
5. The Lender must review the OAHP restructuring commitment for requirements that are or are not required under the Section 221 loan or that may be different amounts. All discrepancies must be discussed with OAHP to determine a resolution that is acceptable to both programs. An example is: OAHP, in their Section 223(a)(7) review, based on a limited scope of repairs, requires an initial deposit to replacement reserve. Under Section 221, substantial rehabilitation is required. OAHP may be willing to waive the requirement since the project will be substantially rehabilitated under the Section 221 loan.
6. Calculation of the Maximum Insurable Mortgage. The HUD maximum insurable mortgage is limited to the lesser of the following mortgage criteria.
  - o Criterion 3. Amount Based on Value or Replacement Cost: 90% of HUD replacement cost
  - o Criterion 4. Amount Based on Limitations Per Family Unit: Published Section 221 limits (updated annually) as adjusted by the High Cost Percentage for the HUB/Program Center and indexing of the basic statutory mortgage limits in accordance with Section 206A of the National Housing Act.

- Criterion 5. Amount Based on Debt Service Ratio:
  - A. Under normal processing, the FHA insured mortgage is an amount supported by 90% of the net income available for debt service. The rent to be used is the lesser of market rent or the Section 8 contract rents. Please note that the OAHP underwriting and development of expenses consist of items generally not considered in processing under Section 221 program. These expenses include, but are not limited to, an operating expense cushion to cover the 2<sup>nd</sup> loan; debt service on any new loan to finance physical needs or other costs; Incentive Performance Fee; and a reasonable return to the owner. These additional items should be included in the project expenses.
  - B. When Section 8 “Exception Rent” processing is requested, the FHA insured mortgage is an amount supported by 90% of the net income available for debt service based upon the Section 8 HAP contract rents, to be in effect on or before FHA initial endorsement of the note. The additional expense items used in the OAHP underwriting should be included in the project expenses. OAHP may use exception rents in renewing the Section 8 contract only when they have determined that 1) the loss of the project would seriously and adversely impact the tenants and the community, for example, by displacing tenants who would have serious difficulty finding comparable Housing (see MAHRA §514.g.2.a.i); and 2) the project’s Net Operating Income is insufficient to support OAHP’s determination of operating expenses, including reserve deposits, debt service on loans and reasonable return to the project’s owner.

Note: OAHP has indicated that some transactions may require cushion margin/debt coverage greater than 1.1111111. These transactions will be handled on a case-by-case basis.

- Criterion 11. Amount Based on Deduction of Grant(s), Loan(s), Tax Credit(s) and Gift(s) for Mortgageable Items: Amount remaining after grants, loans, tax credit proceeds and gifts attributable to mortgageable costs is deducted from replacement costs.
7. *Loan Closing.* The closing process will follow HUD’s current procedures for closing on a first mortgage with a Firm Commitment for FHA mortgage insurance under Section 221(d) with the exception that the loan closes concurrently with the Mark-to-Market restructuring, partial payments of claim, etc.