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CHAPTER 4. GENERAL UNDERWRITING CONSIDERATIONS FOR LENDERS

- 4-1. APPLICATION STAGES. HUD does not prescribe particular processing stages. The application and processing may be divided into three stages similar to HUD's (described in paragraphs A - E, below) or you may use another system.

The exhibits and information for the firm commitment stage must be submitted and a firm commitment issued before initial endorsement (coinsurance of advances) or start of construction (coinsurance on completion). (See Chapter 5 for list of exhibits at each stage. Applications must be processed according to Chapters 6 - 11). The HUD environmental assessment in paragraph 6-8 must always be done at the first submission.

- A. Site Appraisal and Market Analysis (SAMA) - new construction projects
- 1) Determine market need for the proposed project by type of units, size, number of rooms, etc.
  - 2) Estimate the obtainable rents and value of the site fully improved.
- B. Feasibility (substantial rehabilitation projects)
- 1) Do a basic underwriting analysis, which may include a credit and financial analysis.
  - 2) Establish economic feasibility, including type and extent of required rehabilitation, estimated post-rehabilitation replacement cost, and "as-is" value of the property, project income, etc. The analysis is generally comprehensive enough to obviate the need for further lender review before the firm commitment stage.
- C. Conditional commitment
- 1) Analyze proposal and its economics including project schematics and outline specifications developed by the sponsor and its architect.
  - 2) Examine credit and financial capacity of principals and general contractor.
- D. Firm commitment
- 1) Review any updated information and final contract documents to see they agree with any findings made in earlier processing stages and meet all standards and requirements for a firm commitment.
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- (4-1) 2) Decide whether to issue a firm commitment to coinsure construction advances or to coinsure on completion. This is solely your decision.

E. Combined stages. You may accept a single combined application and process it directly to firm commitment. If, during processing, you find the project is eligible but the mortgagor is not or the material submitted is not enough to issue a firm commitment, you may issue a SAMA or conditional commitment stating your findings (e.g., the findings in paragraph A, if only a SAMA can be issued - see paragraph 4-5 for partial return of fees in this case).

NOTE: Commitments and fees (see paragraph 4-5) are not transferable between the regular insurance and coinsurance programs or between coinsuring lenders and HUD field offices.

#### 4-2. CHANGES IN PROPOSALS

- A. Significant deviation. When a mortgagor's proposal changes at any stage through firm commitment, you must determine if it is a significant deviation from the original concept. If so, you may reject the application. You may require a new application and fee if the mortgagor wishes to proceed again.
- B. Allowable changes. It is not a significant deviation if the change meets the same program objectives. The items below may be changed by the mortgagor or lender in a counterproposal (see paragraph D) and a new application or fee cannot be required (but process changes to determine feasibility):
- 1) Rents\*
  - 2) Unit number\*, mix, or size
  - 3) Number of floors or buildings with the same building type (Part A of the Forms HUD-92013 and HUD-92264)
  - 4) Deletion or substitution of similar buildings in a rehabilitation proposal if necessary for feasibility
  - 5) Parking requirements
  - 6) Gross residential or commercial area\*
  - 7) Equipment and services included in rent
  - 8) Expenses
  - 9) Taxes

- (4-2)
- 10) Replacement cost
  - 11) Market price of site
  - 12) Cash requirements

Note: It is a significant deviation if rents, unit number or gross project area change as described in paragraph C.5.

C. Rejection. The changes below are generally cause for rejection of an application.

- 1) Substantial change in mortgagor (e.g., primary principals)
- 2) Location
- 3) Building type (from low to high rise or vice versa; from walk-up to townhouse, etc.)
- 4) Market to be served
- 5) Rents, unit number or gross project area changes great enough to affect market potential require a new market analysis.

D. Counterproposal by lender

- 1) You may not suggest or require substantial changes that deviate from the concept agreed to in a previous processing stage except to ensure conformity with that concept.
- 2) You may counterpropose in writing the allowable changes in paragraph B only if required for feasibility. The mortgagor must agree in writing to a counterproposal before proceeding further.

4-3. MAXIMUM MORTGAGE LIMITS. (See Chapters 9 and 10 for details on mortgage amounts and calculations.) Each coinsured mortgage will be the least of the following:

A. Replacement cost. Cannot exceed the applicable percentage of the project's total replacement cost as follows:

Section	Mortgagor	Percentage
221(d)(3)	General (includes Profit-motivated and Limited Distribution)	90
221(d)(3)	Cooperative	98
221(d)(3)	All others (includes Nonprofit)	100
221(d)(4)	All Mortgagors	90

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- (4-3) B. Statutory unit cost: Cannot exceed the sum of the project's total calculated statutory cost limit (adjusted by any high-cost factor) plus the applicable percentage below of structural and land costs not attributable to dwelling use:

Section	Mortgagor	Percentage
(1) 221(d)(3)	General and Limited Distribution	90
(2) 221(d)(3)	Cooperative	98
(3) 221(d)(3)	All others	100
(4) 221(d)(4)	All Mortgagors	90

NOTE: The high-cost area factors for each market area and the statutory cost limits are available from the HUD field office with jurisdiction.

- C. Debt service. Cannot exceed the amount that can be amortized by the applicable percentage of net income set out below:

Section	Mortgagor	Percentage
(1) 221(d)(3)	General and Limited Distribution	90
(2) 221(d)(3)	All others, including Cooperatives	95
(3) 221(d)(4)	All Mortgagors	90

#### 4-4. OTHER BASIC REQUIREMENTS OF THE MORTGAGE

- A. Maximum term. The lesser of:

- 1) 40 years from date of first payment to principal, or
- 2) 75 percent of the lender's estimate of the project's remaining economic life.

- B. Interest rate

- 1) The interest rate in a commitment to coinsure must be agreed on by the mortgagor and coinsuring lender when the commitment is issued.
- 2) It may be increased or decreased only after reprocessing and issuing an amended commitment.

(4-4) 3) It may not be increased after initial endorsement (insurance of advances) or start of construction (insurance upon completion), except that, where a mortgage increase is requested, processed and approved, a higher (or lower) rate may be applied to the amount of the increase only.

C. Requirement for Level Annuity Monthly Payment (LAMP) plan. The mortgage must be self-amortizing and provide for equal monthly payments of interest and principal due the first day of each month under an amortization plan agreed to by the mortgagor and lender and acceptable to HUD.

4-5. FEES AND CHARGES. There are maximum fees and charges that the lender may collect in connection with the coinsurance program.

A. You may collect from the mortgagor an application fee and service charge for processing an application, inspecting the project and closing the mortgage. However, you may never charge more than the following:

1) Application and processing fee - may not exceed \$3.00 per \$1,000 of the amount of mortgage requested.

- You may collect this fee in stages commensurate with processing performed (e.g., \$1.00 per \$1,000 at each of three stages, \$1.50 per \$1,000 at each of two stages, etc. - see paragraph 4-1).

- You must adjust the fee at final endorsement so that the total amount does not exceed \$3.00 per \$1,000 of the finally endorsed mortgage.

- If a single application intended for a firm commitment receives only a SAMA or conditional commitment, you must return some of the fee because it took less processing - i.e., if a firm commitment application was submitted, but you can only issue a conditional commitment, return \$1.00 per \$1,000.

2) Service charge or financing fee - may not exceed \$2.00 per \$100 of the amount of mortgage.

- You may not collect this fee before initial endorsement of the mortgage. It is intended to reimburse you for costs associated with initial and final closing of the project, including legal fees and administering the construction loan.

- (4-5) 3) Permanent placement fee - may not exceed \$1.50 per \$100 of mortgage amount.
- You may not collect this fee before initial endorsement of the mortgage.
  - If you collect this fee, it must include all permanent placement expenses except discounts and bond fees.
  - Where GNMA Mortgage Backed Securities are involved, you may not assess an additional charge for the MBS application fee or for the securities custodial or delivery fee.
- 4) Construction inspection fee - may not exceed \$5.00 per \$1,000 of the mortgage amount, payable at initial endorsement for insurance of advances or before construction start for insurance upon completion cases.
- B. Discounts. You may also elect to collect reasonable discount fees. Discounts must be:
- 1) Outside the mortgage computation.
  - 2) Disclosed at endorsement.
  - 3) No greater than comparable fees in the Section 221 full insurance program.
- C. Additional lender's fee. Beginning on the anniversary of initial endorsement (12 months after the date of endorsement for coinsurance on completion), you may collect an additional fee of .25 percent per year of the average outstanding balance of the mortgage.
- 1) This may not be collected unless it was included in the debt service computation on Form HUD-92264-A processed before commitment.
  - 2) You may use this fee to offset the cost of any reinsurance or retain it for your account.

4-6. MORTGAGE INSURANCE PREMIUMS. (Details are in Handbook 4561.2.)

- A. You must collect from the mortgagor an annual mortgage insurance premium (MIP) and share it with HUD as described in paragraphs D (insurance of advances) and E (insurance upon completion), below.
- B. Method and frequency of payment. Cash (by check to the Office of Finance and Accounting) or debentures, continuing annually until the coinsurance contract ends.

- (4-6) C. Adjustments to required MIP: None may be made for delinquent payments or prepayments on the mortgage except for the pro-rata refund of MIP permitted by 24 CFR 251.804.
- D. Insurance of advances
- 1) Collect the first year's MIP (1 percent of the face amount of the mortgage) from the mortgagor at initial endorsement. You may include this amount in the replacement cost computation.
    - a) For the first year's MIP, .65 percent is payable to HUD when HUD initially endorses the note for coinsurance.
    - b) Retain the remaining .35 percent.
  - 2) After the first year and until the first payment to principal, MIP is .5 percent annually. Collect 1/12 of the MIP monthly from the mortgagor, and pay the total collected to HUD annually.
  - 3) Beginning with the first payment to principal, MIP is .5 percent a year. Collect 1/12 of the MIP monthly from the mortgagor and:
    - a) Pay .4 percent to HUD annually.
    - b) Retain the remaining .1 percent.
- E. Insurance upon completion. There is no MIP during construction. MIP is .5 percent of the endorsed mortgage amount per year from the date of endorsement until the mortgage is paid or the coinsurance contract ends.
- 1) Collect the first year's .5 percent from the mortgagor at endorsement and pay to HUD.
  - 2) Beginning with the first payment to principal, collect 1/12 of the .5 percent MIP monthly from the mortgagor and:
    - a) Pay .4 percent to HUD annually.
    - b) Retain the remaining .1 percent.
- 4-7. REINSURANCE. The lender may reinsure any part of the potential loss on an individual mortgage. However, the percentage of reinsurance affects the insurance benefits payable by HUD. (See Handbook 4561.1 for details.)
- A. Reinsurance up to 50 percent of risk:
- Lender is responsible for 5 percent deductible of outstanding mortgage.
  - Any remaining loss is shared 85 percent (HUD) and 15 percent (lender).

(4-7) B. Reinsurance over 50 percent of risk:

- Lender is responsible for 5 percent deductible of outstanding mortgage.
- HUD pays only 85 percent of its normal 85 percent share, or 72.25 percent. Lender pays remaining 27.75 percent.

4-8. UNDERWRITING CONSIDERATIONS. This section highlights certain special features of HUD-required mortgage underwriting. Details of underwriting and lender responsibilities are in Chapter 6. Instructions about each technical discipline are in Chapters 7 through 11.

- A. Builder's and Sponsor's Profit and Risk Allowance (BSPRA). An amount included in replacement cost for profit motivated and limited distribution mortgagors where an identity of interest (See paragraph 4-9) exists between the mortgagor and general contractor. BSPRA is no more than 10 percent of the total estimated cost of: on-site land improvements; structures; general requirements; general overhead expenses; architect's fees; carrying and financing charges; and legal, organizational and audit expenses.
- B. Sponsor's Profit and Risk Allowance (SPRA). An amount included in replacement cost where no identity of interest (see paragraph 4-9) exists between the general contractor and mortgagor. SPRA is no more than 10 percent of the total estimated cost of: architect's fee; carrying and financing charges; and legal, organizational and audit expenses.
- C. Construction inspection. The lender is responsible for inspections during construction or rehabilitation to evaluate performance of contractor and architect and see that project is constructed according to the approved drawings and specifications and construction contract. During construction, the lender must also:
  - Ensure compliance with prevailing wage requirements by reviewing payroll reports and interviewing employees.
  - Determine construction progress on which to base insured advances.

See Chapters 7, 12 and 13 for details.

- D. Cost certification. Required by Section 227 of the National Housing Act and HUD regulations for all rental housing projects. Mortgagors, in all cases, and general contractors, when there is a cost-plus construction contract, must certify actual costs before a project can be finally endorsed. (Procedures are in Chapters 8, 10, and 13.)



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- (4-8) E. Rate of return on investment. Nonprofit mortgagors are not entitled to distributions of project funds; the rate of return for other mortgagors varies from project to project. Mortgagors must compute surplus cash and distributions using Appendix 13 of Handbook 4566.2.
- 1) Limited-distribution mortgagors. Distributions may not exceed the lesser of surplus cash or the distributions available as of the end of the previous fiscal period.
    - a) If the project receives subsidy payments from HUD, distributions are cumulative and earned at the rate in the regulations and administrative procedures for that subsidy program.
    - b) If the project does not receive subsidy payments from HUD, distributions are cumulative and earned annually at a rate prescribed by the lender, consistent with State or local law.
  - 2) Profit-motivated mortgagors. All surplus cash generated during the previous fiscal period may be distributed.
- 4-9. IDENTITY OF INTEREST. An identity of interest exists if:
- A. The mortgagor (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor) has a financial interest in or contractual arrangement with the contractor regarding the project, including site procurement, other than the construction contract or vice versa.
  - B. Any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor is also a general or limited partner, shareholder, director, officer, employee or authorized representative of the contractor or vice versa.
  - C. The contractor advances funds for any obligation of the mortgagor, including site procurement, or pays on behalf of the mortgagor (or provides without cost) architectural or engineering services, except those permitted by the construction contract or owner-architect agreement.
  - D. The mortgagor (or any general or limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor) can directly or through one or more intermediaries control or influence the decisions or policies of the contractor, including apparent control or influence over the decisions or policies, or vice versa.
- "Apparent control or influence" means any relationship that exists between the mortgagor and contractor (or any general or

limited partner, shareholder, director, officer, employee or authorized representative of the mortgagor and contractor) by blood or marriage.

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- (4-9) E. The mortgagor and contractor at any time enter into any agreement, contract or undertaking that changes or cancels any obligation of the other party that is required by the documents executed at initial endorsement.

All questions on identities of interest or situations not covered above must be submitted in writing to HUD Headquarters, Office of Insured Multifamily Development.

4-10. TRANSFER OF PARTIAL INTEREST UNDER PARTICIPATING AGREEMENT.

- A. A partial interest in a coinsured mortgage may be transferred without HUD approval if:
- 1) It will be held by an approved coinsuring lender ("principal lender").
  - 2) The principal lender retains at least a 10 percent beneficial interest in the coinsured mortgage until final endorsement (endorsement in coinsurance on completion cases) and at least 5 percent after that.
  - 3) The participation or partial interest is issued to and held by a:
    - a) Lender approved by the Commissioner
    - b) Pension or retirement fund or a profitsharing plan maintained and administered by a corporation or government or by a trustee or trustees which the principal lender determines has the authority to acquire a partial interest in a coinsured mortgage under the conditions of this section.
  - 4) The participation agreement or arrangement provides that the principal lender will remain the lender of record under the contract of coinsurance and that HUD has no obligation to recognize or do business with any other party except the lender of record.

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