**Chapter 18**

**Section 223(a)(7)**

**18.1 Purpose of Section 223(a)(7)**

Section 223(a)(7) of the National Housing Act (NHA) permits refinancing of HUD-insured multifamily projects. Refinancing through Section 223(a)(7) results in prepayment of the existing mortgage, endorsement of a new mortgage and assignment of a new project number. Refinancing through Section 223(a)(7) typically reduces project debt service and increases operating cash flow by lowering the interest rate of the mortgage and/or by extending the amortization period. The increased project cash flow benefits properties and owners and reduces risk to the FHA Insurance Fund.

Section 223(a)(7) is applicable only to certain mortgages currently insured by FHA, as described below, and to HUD-held loans on projects subject to the Multifamily Assisted Housing Reform and Affordability Act of 1997 (MAHRA). A mortgage refinanced pursuant to Section 223(a)(7) is insured under the same section of the NHA as was the mortgage originally insured under that section of the act. For example, a 223(a)(7) refinancing of a mortgage insured under Section 221(d)(4) or Section 207 pursuant to Section 223(f) would continue to be insured under the respective original Section.

Section 223(a)(7) refinancing is limited to existing properties in residential use. Section 223(a)(7) refinancing cannot include funds for new construction or expansion of the height or footprint of an existing building, or any repairs that involve ground disturbance. Section 223(a)(7) mortgage proceeds may be used to fund (a) the payoff of existing FHA-recognized indebtedness, (b) the cost of refinancing, (c) the cost of critical and non-critical repairs (as described in the required Capital Needs Assessment, subject to the cost limits, and (d)deposits to reserve for replacement accounts, as described in Section 5.10. Equity take-outs (often called “cash-out refinancing”) are not permitted under Section 223(a)(7).

**18.2 Consolidation of applicable guidance**

This Chapter provides guidance on processing Section 223(a)(7) refinancing transactions for all currently insured multifamily properties. Programs administered by the Office of Healthcare Programs are not covered by this Chapter.

**18.3 Basic Program Requirements**

Standard Processing Time. In general, Section 223(a)(7) transactions should be processed expeditiously to reach a Firm Commitment decision within 30 calendar days of receipt of a complete application.

1. Eligibility. These instructions apply to the refinancing of multifamily properties with full insurance mortgages and previously coinsured mortgages converted to full insurance. Mortgages excluded from these instructions are:
2. risk share mortgages,
3. co-insured mortgages, and
4. Section 202 loans and other HUD-held mortgages (other than those subject to a debt restructuring under the Multifamily Assisted Housing Reform and Affordability Act (MAHRA)).
5. Maximum mortgage (Form HUD-92264-A apply Criteria 1, 2, 5, & 10). The mortgage may not exceed the lowest of the following:
	1. Criterion 1 - Amount that is lower than the lowest of the amounts derived in paragraphs 2., 3., and 4., of this Section B below.
	2. Criterion 2 - Modified to read the “Original principal amount of the existing insured mortgage” that is to be refinanced (or the sum of the original principal amount of all mortgages to be refinanced if two or more mortgages on one single property are being refinanced). NOTE: Both loans must be on one property with the same Single Asset Mortgagor Entity with identical legal descriptions (e.g., insured first mortgage coupled with a Section 241(a) loan). (e.g., insured first mortgage coupled with a Section 241(a) loan). By statute, Section 223(a)(7) refinancing cannot be used to consolidate multiple loans on different projects secured by collateral with different legal descriptions that will remain separate, even if the sites are adjacent. See also Section 3.1.CC Scattered Sites and Section 18.3.L. Refinancing M2M and Partial Payment of Claim (PPC) Properties for additional restrictions.".
	3. Criterion 10 - Amount based on the cost to refinance the existing insured mortgage and other permitted debt, including any accrued but unpaid interest, permitted repairs, capital improvements, and loan closing charges. Specifically, the Criterion 10 Amount includes the unpaid principal balance of the existing insured mortgage (or mortgages if more than a single mortgage are being refinanced), plus a., b. and c. below:
		1. Loan closing charges, including the application fee, upfront Mortgage Insurance Premium (MIP), financing fee, total costs of prepayment penalties associated with the mortgage note, title and recording fees, and legal fees associated with the refinancing, and required deposits to the reserve for replacements.
			1. The cost of defeasance of any existing bond issue and bond discounts exceeding 10% of the proposed mortgage amount may not be included.
			2. Discounts. The cost of any discounts may not be included in estimating the maximum mortgage amount.
		2. Outstanding debt incurred in connection with capital improvements made to the property that are deemed acceptable to the Production Division Director of the Regional Office or other designated authority.

Not eligible for inclusion in calculating the maximum mortgage amount available for refinancing under Section 223(a)(7) is indebtedness incurred in connection with funding operating deficits, deferred management fees, deferred development fees or other non-capital costs (other than Section 223(d) loans) nor are past-due payables. See Section 8.5.B.7 for a discussion of clearing or resolving past-due payables at the time of closing.

* + 1. HUD-approved Critical and Non-critical repairs costs (as approved by the Production Division Director of the Regional Office or other designated authority).

For a discussion of permitted repairs, please see Chapter 5.1.C.1., Eligible Construction Activities by Program, Class of Work, and Chapter 5.10.B., Processing for Refinance or Acquisition, Section 223(f) and 223(a)(7) and 241(a) for Repairs and Alterations.

* + - 1. Generally, Critical repairs must be completed prior to endorsement. See Chapter 5.1.J., Maximum Time for Completion of Repairs.
			2. Non-critical repairs may be deferred but should be completed within twelve months of endorsement. Generally, a 110% escrow will be established, which may be funded with a letter of credit. For further discussion, see Chapter 5.10.L., Funding Repairs, Escrow Agreement for Deferred Repairs. HUD may determine that a larger escrow is appropriate for projects with more extensive repairs or may waive the escrow for very minor replacement cost items.
	1. Criterion 5 - Amount based on debt service ratio. The amount that can be amortized by the applicable percentage described below of the project's estimated net operating income. The mortgage may exceed this amount by capitalizing the savings from any tax abatement that runs with the land. Physical occupancy assumptions used in calculating the project’s estimated net operating income should be based on historical occupancy levels.

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| Rent Structure | Minimum Debt Service Coverage Ratio (DSCR) | Form 92264-A Criterion 5 loan ratio |
| Projects with >90% of units assisted by Project-Based Section 8, and Cooperative Housing insured under Section 213  | 1.05 | 95.0% |
| All other projects | 1.11 | 90.0% |

1. Mortgage term. The term of a new mortgage insured pursuant to Section 223(a)(7) may be extended up to 12 years beyond the maturity date of the existing, originally insured mortgage (extension limited by statute). The term cannot be extended beyond the lesser of (a) 75% of the remaining useful life of the project or (b) the maximum term permitted in the section of the act under which the existing mortgage is insured. If the existing mortgage is the result of a previous refinancing through Section 223(a)(7), or the combined balance of two loans, the longest allowable maturity date of the new mortgage is 12 years beyond the maturity date of the mortgage originally insured under the FHA insurance program, but notwithstanding this allowance, the term may not exceed 75% of remaining useful life of the project.

**Example of allowable term/maturity date extensions**

**for a Section 223(a)(7) refinancing
of a mortgage currently insured under Section 223(f)**

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| **Loan Requirements** |  **Loan Data** |
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| Current loan program | Section 223(f) |
| Maximum permitted term under the applicable program | 35 years |
| Assumed current loan amortization start date | January 1, 2000 |

| **Examples** | **Maturity date (original term)** | **New maximum maturity date if refinanced under 223(a)(7) on January 1, 2010** | **New maximum maturity date if refinanced for a second time under 223(a)(7) on January 1, 2013** |
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| Example 1 | January 1, 2035(35 years) | January 1, 2045(any later maturity would violate the maximum 35-year term limit under the applicable SOA, in this case 223(f)) | January 1, 2047(any later maturity would violate the maximum 12-year extension of the original mortgage’s term) |
| Example 2 | January 1, 2030(30 years) | January 1, 2040(any later maturity would exceed the 30-year term of the original mortgage) | January 1, 2042(any later maturity would violate the maximum 12-year extension of the original mortgage’s term) |

**Example of allowable term/maturity date extensions**

**for a Section 223(a)(7) refinancing
of a mortgage previously insured under Section 221(d)(4)**

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| **Loan Requirements** | **Loan Data** |
| Original loan program | Section 221(d)(4) |
| Maximum permitted term under the 221(d)(4) program | 40 years |
| Assumed amortization start date of the Original 221(d)(4) loan | January 1, 2000 |
| Current loan program (see Example 3 and Example 4 below) | Section 221(d)(4) or Section 223(f) |

| **Examples of permitted term/maturity extensions for loans with different refinancing histories** | **Maturity date (original term) as a Section 221(d)(4) project** | **New maximum maturity date if refinanced under 223(f) on January 1, 2010** | **New maximum maturity date if refinanced under 223(a)(7) on January 1, 2013** |
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| Example 3A (d)(4) loan is refi’d with a 223(f), and that is refi’d with an (a)(7) | January 1, 2040(40 years) | January 1, 2045(the maximum 35-year term limit under the applicable SOA, in this case 223(f)) | January 1, 2048(any later maturity would violate the maximum 35-year term limit under the applicable SOA, in this case 223(f)) |
| Example 4The same (d)(4) loan above is not refi’d with a 223(f) loan, but is refi’d with an (a)(7) | January 1, 2040(40 years) | Not Applicable for this example(No 223(f) refinancing on this date) | January 1, 2052(any later maturity would violate the maximum 12-year extension of the original mortgage’s term) |

If two or more existing FHA-insured multifamily loans (for a single property) are to be refinanced into a single Section 223(a)(7) loan, the term of the new Section 223(a)(7) mortgage may not exceed 12 years beyond the maturity date of the earliest-to-mature originally insured mortgage.

Any extension of the new mortgage term beyond the remaining term of the existing mortgage (or an additional mortgage per the paragraph immediately above) may not result in a mortgage term that exceeds 75% of the remaining useful life of the property.

1. Mortgage Insurance Premium. At endorsement, the borrower must pay an upfront MIP of 50 basis points for market rate housing; 25 basis points for Broadly Affordable housing; 35 basis points for Affordable housing; and 25 basis points for Green/Energy Efficient housing, or as subsequently revised in a Federal Register Notice. The mortgagee of record must submit Form HUD-9807, Request for Termination of Multifamily Mortgage Insurance, to obtain a refund for the borrower of a portion of the MIP paid pursuant to the original mortgage.
2. Environmental review requirements.
	1. HUD has determined programmatically that Section 223(a)(7) projects are categorically excluded, not subject to the laws and authorities (CENST) at 50.4 as per 24 CFR 50.19(b)(21) other than the flood insurance requirements. Transactions that require repairs in excess of routine maintenance are not appropriate for processing under Section 223(a)(7). (See Chapter 9.1 Subsection C, paragraph 1.)
	2. The Lender must submit a HEROS report at the CENST level of review and HUD must review and sign off in HEROS.
	3. Flood insurance. The lender must determine if the property is located in a special flood hazard area (based upon the most recent Flood Hazard Map) per Section 9.5.F. If the site is determined to be in such an area, the borrower must obtain and maintain Flood Insurance coverage for the duration of the mortgage in the amount specified in Chapter 3.
	4. Compliance with MAP radon requirements is encouraged but not required.
3. Fees.
	1. Application fee - The non-refundable application fee paid to HUD is 15 basis points.
	2. Maximum fees – Lenders may charge financing fees that may not exceed the amounts below. Fees may be increased for bond transactions to cover fees associated with costs of issuance. Lender legal fees are not included in Lender Fees for purposes of the calculations below.

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| New Loan Amount | Maximum Lender Fees(not bond transactions) | Maximum Lender Fees(bond transactions) |
| Portion of loan amount above $2,000,000  | 2.00% | 4.00% |
| Loan amount up to $2,000,000 | 3.50% | 5.50% |

* 1. Inspection fee - There is no inspection fee even if there are deferred non-critical repairs.
1. Project Numbering. Projects will be assigned the next FHA number under the same Section of the Act under which the project was originally insured.
2. Regulatory Agreement. A new Regulatory Agreement must be executed at closing under the same Section of the Act as the original loan (including modifying the principal(s) in provision 50). Amending and restating the existing Regulatory Agreement is not permitted.
3. Cost Certification. Cost certification is not required. As a condition of the Firm Commitment, HUD may require the borrower to produce information related to the cost and completion of Critical and Non-critical repairs and to provide appropriate documentation to HUD, including, at a minimum, invoices, receipts and photos, as repair funds are drawn from escrows. The need for site visits in connection with the completion of repairs or escrow draws will be determined by the Technical Branch Chief of the HUD office with jurisdiction over the property. Projects with minor repairs typically would require few, if any, site visits by HUD staff.
4. Commencement of Amortization. Amortization will begin on the first day of the second month following the date of the initial/final endorsement of the mortgage note.
5. Source of Funds for Prepayment Penalty Costs.
	1. Prepayment penalty costs are, as discussed in 18.3.B.3.a., eligible mortgageable costs. The amount of the cost that is not supported by the refinancing must be paid from other sources.
	2. The one exception to the general prohibition that lenders may not pay or otherwise provide funds for borrower costs is that in 223(a)(7) transactions lenders may pay that portion of prepayment penalty costs not covered by the controlling loan criterion.
	3. The lender’s application must include an estimated Sources and Uses statement specifying the amount of any lender fees or profit used to pay prepayment penalty costs and if the total prepayment penalty costs associated with the mortgage note(s) to be repaid exceed such amount, the amount of prepayment penalty costs to be paid from other sources, specifying such source(s).
	4. The amounts of lender fees or profit and borrower or other funds used to pay prepayment penalties should be shown as sources in the project’s Sources and Uses statement referenced in c. above.
	5. The lender may not pay, either directly or indirectly, for repairs or costs other than the Prepayment Penalty as noted above. The source of funds for repairs and transactions costs must be accounted for separately in the project’s Sources and Uses statement referenced in c. above.
6. Refinancing Partial Payment of Claim (PPC) Properties. A recast first mortgage loan and an associated Partial Payment of Claim second mortgage may both be refinanced in a Section 223(a)(7) transaction so long as the new loan amount does not exceed the original principal amount of the recast first mortgage loan (i.e., the modified Mark to Market or PPC restructuring loan mount), and not the original principal amount prior to the PPC or the Mark to Market transaction, and it is clear the market or project conditions have improved to the point there is little risk the new loan will default.
	1. HUD requires that the HUD-held second mortgage be (1) paid off in full or partially paid off; and (2) subordinated and remain secured. If the HUD-held second mortgage is partially paid off or remains unpaid, HUD will maintain the surplus cash split of 25% to owner and 75% to pay down the HUD-held second (statutory under MAHRA). Pursuant to the owner paying down (or paying off) the HUD-held second mortgage with available loan proceeds, mortgage proceeds must first be allocated to fund the reserve for replacement account (in the amount required by the CNA) and make needed repairs to assure the ongoing value and viability of the project.
	2. Upon refinance, debt service payments may not exceed what is currently in place. Since these properties have previously undergone a PPC, HUD would not want them encumbered with additional debt that could negatively affect future financial stability. Consequently, the interest rate on the new mortgage must be competitive enough such that substantial savings in debt service payments will result.
	3. The debt service coverage rate of 1.2x will be required to account for the additional risk inherent with a former PPC.

Processing of such a transaction would follow the same procedure as that of other multiple mortgages permitted to be wrapped into a single 223(a)(7) refinance transaction. HUD regional office production staff should solicit particular input from asset management staff on these transactions.

1. Commitment, Regulatory Agreement and Closing.
	1. Commitment. The commitment should be in letter form listing the: a) insured mortgage amount, b) the Section of the Act with any appropriate further reference, e.g., Section 221(d)(4) pursuant to Section 223(a)(7) or Section 207/223(f) pursuant to Section 223(a)(7), c) loan terms and requirements, d) any required repairs, e) the requirement for executing a new Regulatory Agreement, f) the requirement that the owner notify OAMPO when any repairs deferred until after endorsement are underway and/or completed, and g) any Special Conditions.
	2. The commitment is valid for a period of 90 days. It is not anticipated that extensions will be necessary in a Section 223(a)(7) refinancing. However, the Regional Director may extend Section 223(a)(7) commitments for a maximum of three additional 30-day periods, provided that processing and underwriting conclusions are updated as necessary, so they are current at the time of any extension.
	3. The commitment must require that the existing Reserve for Replacements be transferred in total to the new mortgage and specify the dollar amount of funds to be transferred and the amount of additional replacement deposits. To the extent that the CNA requires an initial deposit to the reserve for replacement account that is less than the current balance of the existing reserve account, than any immediate repairs required by the CNA may be paid from funds in the existing reserve account. (See Chapter 8 for additional guidance).
	4. Closing. Loans shall be closed in accordance with Chapter 19 (Closing Guide).

**18.4 Processing**

1. Eligible Section 223(a)(7) applications submitted by lenders approved to submit MAP applications must be processed under MAP. See Section 1.1 for additional guidance.
2. Project Analysis. Lenders must provide an analysis with their applications which provides details about the sizing of the Section 223(a)(7) mortgage consistent with this guidance and a Sources and Uses statement consistent with such mortgage sizing calculations. The following may serve as an example of the content and presentation of a submitted Project Analysis:

Click the below link to the MAP Guide on HUD Clips, to review the example project analysis Excel spreadsheet called: “Example of 223(a)(7) Project Analysis required per Chapter 18.4 – Release 1.0 (5/4/2016):”

<https://www.hud.gov/program_offices/administration/hudclips/guidebooks/hsg-GB4430>

**The following is an example of a sample transaction – the data shown is for illustration purposes only**



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1. Verification of existing borrower debt. The lender must verify the amount and terms, including prepayment penalties and repayment terms, of existing insured mortgage debt and any other secured or unsecured debt of the borrower related to the project.
	1. The application should include a copy of the mortgage note, and all documents evidencing other indebtedness.
	2. The lender should compare the mortgage debt information submitted to the lender with information in the project’s financial statements and the title search report. Any discrepancies should be explained in writing by the owner. Since the owner is prohibited from encumbering the project without HUD’s written approval, if the owner is in violation of this provision, the violation should be brought to the attention of the Director of Asset Management in the HUD Regional Office with jurisdiction.
	3. If the borrower has made a loan to fund repairs or betterments (whether or not evidenced on a HUD-approved promissory note), a determination must be made as to whether the debt is acceptable to HUD. If the debt is to be repaid as part of the 223(a)(7), it is not necessary for the debt to be on a HUD-approved form prior to closing. However, if the debt is to remain in place after closing to reduce cash requirements, the owner must evidence the debt on HUD-approved forms.
	4. When additional indebtedness is associated with betterments made to the project and previously financed, the borrower must provide a list of betterments financed by that indebtedness.
2. CNA requirement. A Capital Needs Assessment (CNA) is required for all Section 223(a)(7) applications. See Section 5.10.D. For purposes of Section 223(a)(7) refinancing, an existing CNA may be accepted if it conforms with current guidance for acceptability per Section 5.10.D. under Processing for Refinance or Acquisition, Section 223(f) and 223(a)(7) and 241(a) for Repairs and Alterations.
3. Site visits. Site visits (by either the lender or HUD) may not be required, although in case of large loans or distressed loans regardless of size, a site visit by the lender (and/or HUD staff) may be appropriate and necessary.
4. Section 202 mortgage refinancing. Section 202 projects that are refinanced with an FHA-insured loan are exempt from Section 514(g) of MAHRA under Section 514(h)(2) of that act, for as long as the first FHA refinance loan is outstanding. If that FHA loan is subsequently again refinanced (using Section 223(a)(7) for example), that Section 514(h)(2) exemption is no longer applicable. Thus, if the Section 8 rents were above market, a reduction of rents to market at the expiration of the Contract term is required, and the underwriting of the new loan must reflect rent levels which change from currently allowed rents to market rate rents in accordance with the expiration of the Contract. Such projects must be sent to the Office of Recapitalization for processing the rent reduction under the Mark-to-Market program.

**Example of underwriting a Section 202 project exempt under MAHRA’s mark-to-market provisions**

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| **Loan Requirements** | **Section of the ACT** |
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| Original loan program | Section 202 |

| **202 Loan Examples of rent-setting requirements for loans with different refinancing histories** | **Refinanced into an insured FHA loan in accordance with MAHRA**  | **Exempt from Section 514(g) rent adjustment?** | **Subsequently refinanced** | **Exempt from Section 514(g) rent adjustment for underwriting/loan sizing under MAP?** |
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| Loan 1 | Yes | Yes - Under Section 514(h)(2) | Yes | No - Section 514(h)(2) no longer applies; adjustments would apply at the HAP contract’s expiration |

1. Ownership/Property Management Changes. The lender must verify that any changes in ownership since the endorsement of the existing loan have been properly documented and approved through Previous Participation Review (e.g., submission of Form 2530). Section 223(a)(7) applications should not be submitted until any required Previous Participation Reviews have been processed.
2. Changes of ownership. Any changes of ownership are subject to Transfer of Physical Assets (“TPA”) procedures. However, the TPA application may be processed concurrently with the 223(a)(7) transaction.

**18.5 Application Requirements Checklist**

Checklist and Exhibits.

See Appendix 4H for the Section 223(a)(7) Application Requirements Checklist, at the following HUDClips link: <https://www.hud.gov/sites/documents/4430GAPPHSGG-BM.PDF>