Section I
Handbook Introduction

Chapter 1
Introduction

1.1 Purpose of the Section 232 Handbook

The Section 232 Program is a Federal Housing Administration (FHA) mortgage insurance program that insures HUD-approved Lenders against financial loss from mortgage defaults. This Handbook establishes uniform national standards for applying, underwriting, submitting for approval, closing, managing and servicing mortgages insured or held pursuant to Section 232 of the National Housing Act. Section 232 mortgage insurance is available on mortgages that finance residential healthcare facilities, such as, nursing homes, assisted living facilities and board and care facilities. Eligible mortgages can be for the purchase, refinance, new construction, or substantial rehabilitation – or for a combination of these. Section 232 may also be used to insure mortgages to install fire safety equipment in such properties.

HUD's Office of Healthcare Programs (OHP), and specifically the Office of Residential Care Facilities (ORCF) within OHP, has responsibility for administering the Section 232 mortgage insurance program.

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1.2 Handbook Sections

In addition to this introductory section (consisting of this chapter and a chapter on Lender Relations), there are two primary sections of this Handbook. Those are the Production section and the Asset Management section.

A. **Production**. The Section 232 Production section provides mortgage insurance program descriptions, Borrower and Lender eligibility requirements, application requirements, underwriting standards and construction loan administration requirements. It also provides approved Lenders the instructions to prepare, process and submit loan applications for residential healthcare facilities financed for FHA mortgage insurance.

B. **Asset Management**. The Section 232 Asset Management section is designed to establish national standards for the servicing and risk management of Section 232 FHA-insured mortgages. The section also describes how each Account Executive (AE) works in partnership with the Borrower and Lender to ensure each FHA-Insured 232 mortgage is financially and operationally strong, that each property provides a safe, quality place of residence, and that the loan remains viable for the term of the mortgage.

1.3 Legal Authority

A. **Section 232:** The Section 232 Program is authorized by Section 232 of the National Housing Act (12 U.S.C. 1715w), (12 U.S.C. 1715(b)) and 42 U.S.C. 3535. Statutory authority for the implementation of the Section 232 programs is contained in the basic insuring authority for each of the Section 232 programs. See the National Housing Act, Sections 223(a)(7), 232, 223(d), 232/223(f), and 241. Additionally, Section 211 of the National Housing Act authorizes and directs the Secretary to make such rules and regulations as may be necessary to carry out the provisions of the Act. Regulatory authority includes 24 CFR Parts 200, 232 and Section 5.801.

B. **Section 232/223(f):** Section 223(f) of the National Housing Act was added by Section 311(a) of the Housing and Community Development Act of 1974 and is codified at 12 U.S.C. 1715n(f). The program regulations are found in 24 CFR, Parts 200 and 232.

C. **Section 232/223(a)(7):** The Section 232/223(a)(7) program is authorized by the National Housing Act (12 USC 1715n(a)(7)).

D. **Section 232/241(a):** The Section 232/241(a) program is authorized under the National Housing Act, as amended, Section 241, Public Law 90-448 (12 U.S.C. 1715) and Public Law 94-375 (12 U.S.C. 1715z-6(a)). The program regulations are found in 24 CFR Parts 200 and 241.

E. **Section 223(d):** The Section 223(d) Operating Loss Loan program is authorized by Section 223(d) (12 U.S.C. 1715n(d)) of the National Housing Act 1937, as amended; Public Law 90-448, as amended; and Public Law 91-152, 12 U.S.C. 1715x. The program regulations are found in 24 CFR 207.

F. **Section 232(i):** The Section 232(i) program is authorized under the National Housing Act (12 U.S.C. 1715--w(i)) as amended; Section 203(i) Public Law 93-204 . The program regulations are found in 24 CFR Part 232 Subpart C.

1.4 Relation of Section 232 Handbook to Other Guidance

This Handbook is intended as a comprehensive guide to the Section 232 Program, and supersedes prior handbook or other guidance specifically on the Section 232 Program, consistent with statutory and regulatory requirements. Handbook chapters may include appendices which list the most recently published transactional documents, but the Handbook also covers transactions for which earlier versions of the documents were used and are in force. There may also be instances where existing guidance (particularly related to Borrower audited financial statement matters), references “Multifamily Housing”, because the guidance was issued at a time when the Section 232 Program was a part of the Office of Multifamily Housing, and thus is still applicable to Section 232 Projects. If a particular Section 232 program matter is not addressed in this Handbook, and appears in other guidance, questions regarding applicability may be raised with ORCF.

This Handbook is part of “Program Obligations,” a term used in multiple controlling documents and also at various places in this Handbook. “Program Obligations” means (1) all applicable statutes and any regulations issued by HUD pursuant thereto that apply to the Project, including all amendments to such statutes and regulations, as they become effective, except that changes subject to notice and comment rulemaking shall become effective only upon completion of the rulemaking process, and (2) all current requirements in HUD handbooks and guides, notices, and mortgagee letters that apply to the Project, and all future updates, changes and amendments thereto, as they become effective, except that changes subject to notice and comment rulemaking shall become effective only upon completion of the rulemaking process, and provided that such future updates, changes and amendments shall be applicable to the Project only to the extent that they interpret, clarify and implement terms in this Agreement rather than add or delete provisions from such document. Handbooks, guides, notices, and mortgagee letters are available on HUD’s official website: ~~http://www.hud.gov/offices/adm/hudclips/index.cfm~~ http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips or a successor location to that site.

1.5 Waivers of the Section 232 Handbook

This Handbook provides instructions to Lenders on how to apply, underwrite, close and service 232 insured mortgages consistent with program-related regulatory requirements and other directives. However, there are situations where Lenders are fully aware of ORCF’s program requirements, but have legitimate business reasons for seeking loans for projects that do not fully meet ORCF’s published guidelines. In those circumstances, the Lender must apply for a waiver of the program requirement, in advance of the transaction’s approval. During the course of ORCF’s review of a Lender’s application, it may also be determined that a waiver is needed to obtain or maintain section 232 insurance. In either case, ORCF sets a high standard to approve program waivers.

There are two types of waiver requests: Regulatory waivers and Housing Directive waivers. Regulatory waivers are issued to waive a rule that is published in Title 24 of the Code of Federal Regulations. Generally, rules are established pursuant to statutory authority or by publication in the Federal Register for notice and comment. Regulatory waivers can only be approved by the FHA Commissioner. Housing Directive waivers are issued to waive handbook provisions, Mortgagee Letters and other directives issued by the program office. Housing Directive waivers are approved by OHP management under provisions determined by HUD.

Waiver requests are project specific. A Lender must follow the waiver provisions that are prescribed in its application process. If the waiver request is not associated with an application or not prescribed, the Lender should send the following information to the HUD Underwriter or Account Executive assigned to the project:

A. Project Name,
B. Project Address,
C. FHA Number,
D. Type of Facility,
E. Number of beds,
F. Number of units, and
G. Full explanation and supporting documentation on why the project cannot meet the program requirements.

It is also important to remember that statutory provisions may not be waived unless expressly permitted by statute. Generally, statutory requirements in the areas of fair housing, civil rights, environmental protection, and labor standards may not be waived. .

1.6 Identity of Interest (IOI)

In processing and reviewing applications for FHA-insured mortgages, and in ensuring the long-term viability and ongoing programmatic compliance of FHA-insured projects and their ~~participants~~ members of the development team, operators, and investors pursuant to Section 232 of the National Housing Act, ORCF analyzes the relationship between and among entities. ORCF analyzes relationships in order to determine if one entity *could* significantly influence another entity to an extent that one or more of the entities party to a project-related transaction might be prevented from fully pursuing its own separate interests. In its analysis of the relationships between and among entities, HUD will determine whether any relationship would reasonably give rise to a presumption that the parties may not operate at arm's length. When it is determined that a relationship between or among the proposed parties constitutes an identity of interest, additional requirements and/or certain restrictions will apply.

A. Definition. An **"Identity of Interest"** (whether or not such term is capitalized) is any relationship based on family ties or financial interests between or among two or more entities involved in a project-related transaction which reasonably gives rise to a presumption that the entities may not operate at arms-length. These project-related transactions include, but are not limited to:

1. Establishing the purchase price of the property,
2. Establishing the cost of the design, rehabilitation or construction (or influencing the performance of entities charged with carrying out such work),
3. Establishing the terms of the financing,
4. Controlling the funds, or
5. Providing legal, consulting or management services.

B. Application. An identity of interest shall be deemed to exist between two entities if:

1. An entity, or any Owner of any direct or indirect ownership interest of such entity, or any family member of any such Owner, is:
    a. an Owner of any direct or indirect interest in the other party, or
    b. an officer, director, stockholder, partner, trustee, manager or member of such other party; or

2. Any officer, director, stockholder, partner, trustee, manager, member, principal staff, contract employee or consultant of an entity, or any family member of any such officer, director, trustee, stockholder, partner, trustee, manager, principal staff, contract employee or consultant, is:
    a. an Owner of any direct or indirect interest in the other party, or
    b. an officer, director, stockholder, partner, trustee, manager or member of such other party.

3. A "family member," as used herein, means, with respect to any person, his/her spouse, parents, siblings, children, grandparents, grandchildren, aunts, uncles, mother-in-law, father-in-law, brothers-in-law and sisters-in-law.

C. Determinations. The definition of "identity of interest" is generally applicable to HUD's determination of the appropriateness of relationships between and among parties involved in the financing, development and operation, management and ownership of the project. HUD concerns itself with the relationship between and among entities involved in project-related transactions throughout the development and asset management processes. Due to the inherent complexity of identity of interest determinations, additional guidance on the determinations made and what additional requirements or restrictions are applicable when involving various types of entities is provided in the appropriate chapters.

1. **Identities of interest addressed in this Handbook**. Identities of interest involving the following parties are addressed in this Handbook:
    a. Lenders (FHA Lender) (see Introduction, Chapter 2),
    b. Lenders (Existing Lender, Bridge Lender, and Mezzanine Lender) (see Production, Chapter 3)
    c. Borrowers, Buyers and Sellers (see Production, Chapter 3)
    d. Accounts Receivable Lenders (see Production, Chapter 15)
    e. Architects (see Production, Chapters 10 and 11)

f. Contractors (General Contractors, Subcontractors, Suppliers) (see Production, Chapters 10 and 11)
g. Operators and Management Agents (see Production, Chapter 8 and Asset Management, Chapter 8)

2. **Establishing the purchase price of the property**. HUD defines an identity of interest purchase as a transaction in which there is a relationship of any degree between the seller and purchaser (or any affiliates or principals of any such entities) that survives the transaction and could be construed to not be arms-length. These transactions include instances where a partner is being bought out, but may not necessarily include sale-leaseback transactions (see Production, Chapter 2 & 3).

3. **Establishing the cost of the design, rehabilitation or construction (or influencing the performance of entities charged with carrying out such work)**.
    a. Relationships between the architect and the Borrower, general contractor or subcontractor are discussed in Production, Chapter 11.
    b. Rules pertaining to Cost Certification (see Production, Chapter 11) are impacted when there is an identity of interest between or among:
        i. The Borrower and the general contractor, or
        ii. The Subcontractor and the Borrower, general contractor, another subcontractor, equipment lessor or material supplier
    c. HUD requires the FHA Lender (Lender) to assess a Borrower's previous use of a contractor when an identity of interest is involved (see Production, Chapter 10).

4. **Establishing the terms of the financing**.
    a. The Lender (and any affiliates or principals) cannot have an identity of interest with the Borrower (and any affiliates or principals). The Lender (and any affiliates or principals) also cannot have an identity of interest with a sponsor, general contractor, subcontractor or the seller of a particular transaction (see Introduction, Chapter 2).
    b. ~~The Lender (and any affiliates or principals) cannot have an identity of interest with a consultant (mortgage broker, loan correspondent and packager (see Introduction, Chapter 2).~~ See Production, Chapter 12.2.E for guidance on how to process applications involving an identity of interest between the Lender and a tax credit equity syndicator or an investor.
    c. HUD also examines relationships between and among other Lenders involved in various aspects of the project:
        i. In the case of existing indebtedness created with an identity of interest between the Borrower and the current Lender in a banking relationship, where a third party lender submits the firm application, a Debt Investigation is always required (See Production, Chapter 3).
        ii. Bridge Lenders may have an identity of interest with the Lender, and an existing Lender may engage an identity of interest Lender in taking out a bridge loan of this debt. However, in both instances, HUD will

require the Lender to disclose the relationship and to carefully justify the concluded valuation (see Production, Chapter 3).

iii. Mezzanine Lenders may not have an identity of interest with the principals of Borrower, but may have an identity of interest with the existing Lender, subject to the same scrutiny as Bridge Lenders (see Production, Chapter 3).

iv. In the case of bond financed transactions, a financing fee beyond 3.5% will not be recognized where an identity of interest is involved between the sponsor or Borrower and a Lender (see Production, Chapter 3).

5. **Controlling the funds**.
   a. When accounts receivable (AR) financing is involved, any identity of interest involving the AR Lender must be disclosed, analyzed and mitigated if it is determined that a potential conflict of interest is present (see Production, Chapter 15).
   b. Additional requirements and restrictions may apply when various other identities of interest exist (e.g. between the Borrower and the Operator, Management Agent and/or Lessee/Tenant).

6. **Providing legal, consulting or management services.**
   a. In the Opinions of Borrower's and Operator's Counsel (Form HUD-91275-INST), an attorney signing the Opinion cannot have any identity of interest with any party to the transaction. If another member of the firm has an interest in any entity involved in the transaction, such a relationship must be disclosed. Additionally, attorneys that represent both the Borrower and the Operator must disclose to both parties the inherent conflicts of interest involved.
   b. Fees arising from pre-opening management services provided are not included as a mortgageable cost if an identity of interest exists between the Borrower and the service provider (See Production, Chapter 2).
   c. Any identity of interest between a prospective risk management provider and the Borrower, Lessee or Lender must be disclosed and analyzed (see Asset Management, Chapter 5).

D. Conflict of Interest. HUD Regulations for general lender approval (24 CFR §202.5(l) include the following prohibition of conflicts of interest:

Conflict of interest and responsibility. A mortgagee (Lender) may not pay anything of value, directly or indirectly, in connection with any insured mortgage transaction or transactions to any person or entity if such person or entity has received any other consideration from the mortgagor, seller, builder, or any other person for services related to such transactions or related to the purchase or sale of the mortgaged property, except that consideration, approved by the Secretary, may be paid for services actually performed. The mortgagee shall not pay a referral fee to any person or organization.

In its analysis of relationships between and among parties to project-related transactions and Lenders, HUD will examine identities of interest, in part, to determine if they result in a conflict of interest. When a conflict of interest is determined to exist, certain prohibitions or additional risk mitigation may be required.

[NOTE: See Introduction and Production Chapter 15, for specific discussions of conflicts of interest involving Lenders and AR financing situations.]