

BedfordLending

HUD Refinance 223(f) Repair Rules

HUD allows projects to complete repairs (as a mortgageable cost) during the refinance process. Generally, this process is quite simple. A property condition needs assessment report or “CNA e-Tool” will be completed by a third party vendor which will identify repair items needed (if any) at the property. The property owner can also elect to complete more repairs than what is identified in the report.

Once the scope of work has been defined, the property owner will secure multiple bids for the work needed, HUD will escrow the monies for the repairs out of loan proceeds, and then the work must be completed within a year post-closing.

Occasionally if the scope of work is substantial enough, a project architect and/or general contractor must be brought in to assist with the repair process. The following details these requirements along with other relevant information surrounding repairs.

Eligible Construction Activities

Because HUD has a separate program (221d4) for new construction or gut rehab of buildings, the type of work that can be completed as part of a refinance is more limited in nature.

Repairs and Level 1, Level 2 and Level 3 Alterations are permitted, provided that the Aggregate Cost of all such repairs and alterations does not exceed approximately \$40,000 per door.

1. Additions (defined here as any expansion of a building footprint with conditioned space) are not permitted to dwelling spaces and residential buildings. Adding a patio or a balcony is considered a Level 2 Alteration, given that they are not conditioned spaces;
2. Additions to accessory buildings or additions of minor accessory structures (e.g., carports, storage sheds, swimming pools) may be deemed Level 2 or 3 Alterations, subject to the approval of the Director of the Regional Center/Satellite Office;
3. Construction of a new accessory building (e.g., community building, gym) is permitted as a Level 3 Alteration. New accessory buildings may not exceed a gross floor area of 5,000 square feet.

Levels of Work

1. Level 1 Alterations: "...include the removal and replacement or the covering of existing materials, elements, equipment, or fixtures using new materials, elements, equipment, or fixtures that serve the same purpose." [IEBC Section 503.1].

Examples include removing and replacing an existing flooring or wall finish, etc.

2. Level 2 Alterations: "...include the reconfiguration of space, the addition or elimination of any [exterior] door or window, the reconfiguration or extension of any system, or the installation of any additional equipment." [IEBC Section 504.1]

Examples include 1) adding or demolishing interior walls (partition or loadbearing) to reconfigure dwelling unit layout; 2) adding another bathroom inside a unit; 3) relocating the kitchen within a unit; 4) adding a new air conditioning system that was not previously present to the existing buildings and/or units; 5) adding an elevator to the building, etc.

3. Level 3 Alterations: "...apply where the work area consisting of all reconfigured spaces exceeds 50% of the building area." [IEBC Section 505.1]

When Architects are Required

The Borrower must hire a Project Architect to define work at the property when one of the following conditions is met:

1. The Aggregate Cost (before General Contractor fees or allowances) of all the identified repairs and alterations equals or exceeds \$15,000 per unit. Costs exceeding this threshold are evidence that the proposed repairs and alterations are sufficiently complex that the services of a Project Architect are required to ensure the clarity and accuracy of design and specification documents necessary to guide and evaluate all construction.

HUD may waive the requirement to hire a Project Architect when the Aggregate Cost of all repairs and alterations exceeds \$15,000 per unit but work is limited to repairs and Level 1 Alterations.

2. When the Aggregate Cost of repairs and alterations is less than \$15,000 per unit but the proposed work includes Level 2 or Level 3 Alterations, a Project Architect must be retained to prepare drawings and specifications for the Level 2 or Level 3 Alterations provided as follows:

Work proposed outside the work area where Level 2 or Level 3 Alterations will occur may be excluded from the Project Architect's scope of work.; and

When there are only Level 2 alterations proposed (no Level 3 Alterations), and the Level 2 alterations are nominal (e.g., enlarging a closet in a few units with no accessibility ramifications), the services of a Project Architect are not required.

When General Contractors are Required

The Borrower must hire a General Contractor to conduct all the work defined by the Project Architect and provide coordination as a single point of control for costs, scheduling, and conformance of the work to plans and specifications when one or more of the following conditions are met:

1. The Aggregate Cost of repairs and alterations exceed \$15,000 per unit, excluding General Contractor fees;
2. The proposed work includes Level 3 Alterations; or
3. More than three licensed trade contractors are to be employed for the work.

HUD may waive the requirement to hire a General Contractor when:

1. The Aggregate Cost of all repairs and alterations exceeds \$15,000 per unit but work is limited primarily to Repairs and Level 1 Alterations; or,
2. The owner has substantial experience and proven ability planning and staging construction tasks, coordinating trades, and supplying general requirements.

Licensed Trades

When a General Contractor is not retained, the work items documented by the Architect (e.g., remedies for accessibility deficiencies, limited Level 2 Alterations) must be executed by qualified licensed trades (e.g., a plumber, electrician, framer, tile-setter licensed in the local jurisdiction).

Similarly, repairs and Level 1 Alterations described as individual work items (or a group of closely related items) with an estimated cost of \$35,000 or greater must be performed by qualified licensed trades contractor(s).

Schedule

When a General Contractor is retained, the General Contractor must submit a detailed construction schedule. The Needs Assessor must review the schedule and enter the number for "months to complete" for each work item in the CNA e-Tool. The number entered indicates the number of months from the initial closing until scheduled completion of the particular work item. The months elapsed is not necessarily the minimum duration of the construction for that particular item.

For all other transactions, the Needs Assessor and Lender, in working with the owner, must develop a construction timeline that reflects the planned completion of the work items and enter in the CNA e-Tool as "Months to Complete." The timeline should ensure that all the proposed work (repairs and alterations) be completed as soon as possible and within 12 months of closing.