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Section II Production

Appendix 10.2

Instructions for Approval of Initial/Interim Advances

A. Approving Initial/Interim Advances

1. Before advancing any insured mortgage proceeds, disburse other available funding sources in the following order:
 - a. All funds from the cash escrow established by the Borrower for onsite construction, fees, carrying charges, and financing (front money escrow).
 - b. Grant/loan proceeds furnished by a national, regional, or local community service organization or a private source.
 - c. Grant/loan proceeds furnished by a government agency or instrumentality unless a pro-rata disbursement arrangement has been previously approved by the Office of Residential Care Facilities (ORCF).
2. The amount approved for a requested item cannot exceed the amount claimed by the Borrower.
3. The Lender states on the Application for Insurance of Advance of Mortgage Proceeds the cumulative total of all advances made to the Borrower, including the advance under consideration. Reconcile any discrepancies before recommending approval of the advance. Previous advances must be paid before any subsequent advances are authorized.
4. Lender-approved disbursement amounts shall not exceed the sum of the amounts approved:
 - a. For mortgage insurance;
 - b. For funding from the Borrower's cash escrow; and
 - c. For funding from available grant/loan proceeds.
5. HUD recognizes that, in order to deliver documents to the investor for satisfactory receipt and delivery of the initial GNMA Construction Loan Certificate, a de minimis first draw of the loan proceeds may need to be approved for disbursement at initial closing. The disbursements must be supported by justification and found acceptable to ORCF.

B. Architect's Fees

1. The Architect's cash fee is in the Standard Form of Agreement between Owner

44 and Architect for a Federally Funded or Federally Insured Project,
45 AIA Document B108.

- 46
- 47 2. If there is one agreement for both design and supervisory services, a specific
48 dollar amount must be indicated for each service.
- 49
- 50 3. There may be separate agreements for design and for supervisory services.
- 51
- 52 4. The Architect's design cash fee may be released with the initial advance if
53 the design is complete and ready for construction.
- 54
- 55 5. Design services provided by others as detailed in the AIA B108 must be
56 supported by contracts approved by HUD during commitment processing before
57 any funds may be advanced.
- 58
- 59 6. The Mortgagor's and Architect's Certificate Application for Insurance of
60 Advance of Mortgage Proceeds (Form HUD-92403-1-ORCF), must accompany
61 any request or partial request for advance of the design fee.
- 62
- 63 7. The Architect's supervisory cash fee is advanced based on a percentage of
64 completion method. The maximum amount that may be approved is computed by
65 multiplying the Architect's supervisory cash fee by the percentage of work
66 completed and approved on the Contractor's Requisition – Project Mortgages,
67 then deducting the total of installments previously paid.
- 68
- 69 8. There is no "holdback" applied to the disbursements approved from the Architect's
70 Cash Fee.
- 71

72 C. For Insurance of Advances, the Carrying Charges, Financing, Legal, and Audit Expense
73 must not exceed their allocations in the Building Loan Agreement. Approve items due or
74 already paid by the Borrower which are supported by bills or paid receipts. Do not approve
75 costs for interest, taxes and insurance incurred during early start period.

76
77 Note: At cost certification, certify to the actual cost without regard to release limitations
78 imposed by the Building Loan Agreement during the Construction period.

- 79
- 80 1. Interest is to be advanced only when and as earned. The Lender must specify on
81 Application for Insurance of Advance of Mortgage Proceeds, the period(s) for
82 which interest is requested and the amount for each period.
 - 83 a. At initial closing, verify as to whether a 360 or 365-day (or 366, if leap year)
84 factor is to be used in calculating interest. Check each interest request for
85 accuracy based on the factor indicated, and the annual interest rate approved
86 at Initial Closing.
 - 87 b. The Lender is prohibited from drawing down interest and refunding a portion of
88 the money to the Borrower. Such practice constitutes a kickback and is not
89 acceptable to HUD and will be treated as a direct mortgage reduction.

- 90
91 2. Taxes. In approving amounts for this line item:
92 a. Do not allow amounts which accrued before Initial Closing.
93 b. Approve invoices which are payable during construction, even if a portion of
94 the billing period will be after an allowable cutoff date. Necessary adjustments
95 will be made at the time of cost certification.
96
97 3. Insurance. Allow amounts for fire, windstorm, extended coverage, liability, and
98 other risk insurance customarily insured against in the community.
99 a. Do not allow amounts which accrued before Initial Closing.
100 b. Do not approve invoices/receipts for workers' compensation and/or public
101 liability insurance which are included in the cost estimate.
102
103 4. Mortgage Insurance Premium may not exceed the amount due for 1 year.
104
105 5. Initial service charge and permanent lender fees are limited to:
106 a. The actual amount paid, or the amount stipulated in the Mortgagee's Lender
107 Certification (Form HUD-243492434-ORCF), whichever is less.
108 b. The initial service fee cannot exceed 2 percent.
109 c. The combined amount may not exceed 3.5 percent of the mortgage.
110 d. Note: If the 3.5 percent included in processing exceeds the financing fee
111 charges by the mortgagee, identify the excess as restricted funds.
112
113 6. Legal fees may be allowed for:
114 a. Counsel to create the Borrower entity; however, legal services for the
115 creation of tax shelters, trusts, estate planning maneuvers, and similar efforts
116 intended to benefit the project's principals should be excluded.
117 b. Costs associated with counsel's review of initial and final closing
118 documents.
119 c. Normal interim activities in creating a project.
120 d. Documented costs for items in paragraphs 6.a, b, and c above which are due
121 and payable before or at final closing may be approved in the initial advance,
122 provided the limitation in paragraph 6.e below is not exceeded.
123 e. Seventy-five percent may be disbursed at initial closing or during
124 construction. The remaining 25 percent may not be released before Final
125 Closing.
126

127 NOTE: Do not allow legal expenses connected with land acquisition, title and
128 recording charges and/or obtaining zoning as they are reflected in the land value.
129 Amounts included in the Maximum Insurable Loan Calculation for legal and
130 audit expenses are not blanket allowances, but ordinarily set an upper limit on
131 allowable amounts. Atypical fees must be borne by the Borrower, unless in an
132 exceptionally complex case, a higher fee is proven by the Borrower to be
133 necessary and reasonable. Detailed invoices and/or other documentation are/is
134 required as to the reasonableness, purpose, necessity, and proper classification of
135 all items in the category.

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7. Organizational Fees:
- a. The amount included in the replacement cost estimate for organizational fees is an allowance to reimburse the Borrower for costs incurred to:
 - i. Initiate a project;
 - ii. Organize the Borrower entity;
 - iii. Organize its planning, financing and construction, and
 - iv. ~~Control and~~ Assist the borrower to manage construction through Closing.
 - v. Third-Party costs (Appraiser etc.)
 - b. Release based upon the following:
 - i. Disburse 65 percent at initial closing.
 - ii. Disburse 15 percent during construction based upon a percentage of completion.
 - iii. Disburse the remaining 20 percent at Final Closing.

Note: Lender's Third-Party Costs, reflected in Organization Costs are exempted from the 65% rule. The rule only applies to the Borrower's organizational costs.
 - c. This allowance may not be used to subordinate the cash requirements for closing.
 - d. At cost certification allow only the amount included in the Maximum Insurable Loan Calculation for organizational fees, unless fully supporting documentation is submitted by the Borrower which justifies the need for and reasonableness of the additional expenditure. Any costs incurred in excess of this allowance are not eligible for recognition in processing a mortgage increase or the equity computation on the Maximum Insurable Loan Calculation.
8. Audit fees associated with obtaining an accountant's opinion of the Borrower's cost certification cannot be advanced until Final Closing.
9. Title and Recording. Approve amounts typically incurred for:
- a. Title search and policy at the time of Initial Closing;
 - b. Recording fees at Initial Closing;
 - c. Mortgage and stamp taxes;
 - d. Survey recording fees;
 - e. Updating title policy during construction;
 - f. Final title policy and recording charges; and
 - g. Legal fees actually incurred and clearly for these purposes.
- ** Do not fully disburse these funds at Initial Closing. Ensure that sufficient funds are maintained in the account to cover title and recording costs required at Final Closing. This may require the approval of an amount less than that requested in the initial draw.
- ** Do not disburse funds for title and recording cost associated with acquisition of the land or property.

181 ** Legal, organizational, title, recording costs and taxes incurred in connection
182 with the site purchase may be added to the cost of the land in establishing the
183 latest arms' length purchase price.
184

185 10. Developer's fee is provided in the estimated replacement cost involving non-profit
186 Borrowers. Part or the entire fee may be used to pay for transactional costs
187 associated with developing the project including but not limited to:

- 188 a. Reduction of the estimated closing costs of the project;
- 189 b. Staff salaries;
- 190 c. Non-profit working capital deposit;
- 191 d. Relocation expenses;
- 192 e. Operating deficit escrow;
- 193 f. Financing fees over and above the 3.5 percent included in the
194 estimated replacement cost of the project;
- 195 g. Environment studies; and
- 196 h. Housing Consultant services provided by either in-house staff or
197 contractor.

198
199 11. Tap fees, soil testing and other fees. Approved disbursement must be fully
200 supported and is not to exceed the amount estimated in the general contractor's or
201 Borrower's list of other fees for requested items. Approve disbursement only for
202 items actually due.
203

204 12. The contingency reserve is included in the replacement cost of substantial
205 rehabilitation projects.

- 206 a. Use the contingency reserve for:
 - 207 i. Unforeseen costs of necessary changes approved by ORCF.
 - 208 ii. Unanticipated soft costs associated with extension of time change
209 orders approved by ORCF.
- 210 b. Changes classified as betterments are ineligible for funding.

211
212 13. Third-Party Lender Expenses: Fees to be paid for third-party review costs of the
213 Lender including but not limited to Architectural reviews, Cost reviews, appraisals,
214 and market studies.
215

216 14. At Initial Closing, HUD fees for examination and inspection.
217

218 15. Sums allocated to acquisition cost of land or existing building.
219

220 D. Allocation of Cash Available to the Borrower:

221
222 1. Allocation of cash available to the Borrower is limited to the following items and,
223 when applicable, should be identified in an unused column on Financial Record of
224 Mortgage Loan Transaction:

- 225 a. New Construction.

- 226 i. HUD's estimate of the "as-is" value of land or the actual latest arms'
227 length purchase price, whichever is less. The latest arms' length
228 purchase price may include the following costs incurred in connection
229 with the site purchase:
- 230 1. Legal fees associated with negotiations for acquisition of land,
231 zoning, and examination of title on the purchase or defense of
232 title after purchase.
 - 233 2. Prepaid special assessments.
 - 234 3. Interest on bridge loans to purchase property after the date of
235 submission of the initial application for mortgage insurance.
 - 236 4. Taxes.
 - 237 5. Cost of improvements made to the project site by the
238 sponsor/Borrower.
- 239 b. Cash escrow to cover offsite construction cost.
240 c. Cost of any demolition reflected in the Fair Market Value of Land. Payment is
241 approved as demolition progresses.
242 d. Construction and/or permanent loan discounts required to be paid at initial
243 closing.
244 e. Escrow to cover interest shortfall escrow, working capital deposit, initial
245 operating deposit, ~~nonrealtynon-realty~~ items and any permanent loan
246 discounts not required to be paid at initial closing.
247 f. Remaining balance may be used to fund any approved change orders or held
248 until Final Closing.
- 249
- 250 2. Rehabilitation of Existing Construction.
- 251 a. HUD's estimate of the "as-is" value by market comparison or the Borrower's
252 acquisition cost/existing indebtedness, whichever is less.
 - 253 b. Items 1a through 1f above.
- 254
- 255 E. Restricted Excess Mortgage Proceeds:
- 256
- 257 Restricted excess mortgage proceeds are those excess mortgage proceeds determined
258 not to be available to the Borrower during construction, i.e., difference by which the
259 HUD estimate exceeds contract amounts.
- 260
- 261 1. These funds cannot be used to satisfy any escrow requirements and must be held
262 until Final Closing.
 - 263
 - 264 2. Identify these funds in an unused column of the Financial Record of Mortgage
265 Loan Transaction as restricted funds.
 - 266
- 267 F. Lender Duties for Processing the Application for Insurance of Advance of Mortgage
268 Proceeds. The Lender must review and approve the Application for Insurance of
269 Advance of Mortgage Proceeds conducting the following major responsibilities:
270

- 271 1. Reconcile any discrepancies between the cumulative total for all advances,
272 including the advance under consideration, and conclusions reached in the
273 processing before recommending the advance for approval.
274 a. Enter any required adjustments in Column B and note, “No Adjustment
275 Necessary, Except Asas Indicated,” or “No Adjustment Necessary,” as
276 appropriate.
277 b. Enter the approved amount in the “Certificate of Mortgage Insurance” on
278 the face of the form, and where the request is reduced; explain the
279 disallowance on the form’s reverse side.
280
- 281 2. Determine monthly that advances are proportionate to construction progress.
282 a. Require the Lender’s underwriter to advise you where advances for “soft
283 costs”, i.e., financing and carrying charges, are in excess of work progress as
284 shown by the most current Progress Schedule accepted by the HUD and the
285 percentage of project completion reflected on the Contractor’s Requisition –
286 Project Mortgages.
287 b. Take action where the mortgage is not in balance due to the fault of the
288 contractor.
289
- 290 3. Secure approval from HUD for any advance requesting release of any portion of
291 the contractor’s 10 percent holdback.
292
- 293 4. Maintain a record of approved disbursements on the Financial Record of
294 Mortgage Loan Transaction.
295
- 296 G. Certificate of Mortgage Insurance: (Prepare when the advance is eligible for approval.)
297
- 298 1. The approved sum is the total for the Contractor’s Requisition and other eligible
299 line items.
300
- 301 2. The total approved for any item must not exceed the amount allocated to the item unless
302 the Lender submits a written request to HUD for permission to reallocate funds
303 between line items.
304
- 305 3. The sum approved for mortgage insurance is the amount approved for advance less
306 any funds remaining in the front money escrow and any grant/loan proceeds.
307
- 308 4. For interim advances, the Lender is to prepare this Certificate and sign for HUD, to
309 increase the amount of mortgage insurance.
310
- 311 5. After signing the Application for Insurance of Advance of Mortgage Proceeds in
312 the space for the Authorized HUD Official, and signing the Contractor’s Requisition
313 –Project Mortgages (HUD-92448-ORCF) for the Director of Housing Development,
314 the Lender sends a PDF copy of the Application for Insurance of Advance of
315 Mortgage Proceeds, Contractor’s Requisition – Project Mortgages, Financial Record
316 of Mortgage Loan Transaction, and supporting documentation to the HUD ORCF

317 Construction Manager.

318

319 H. ~~HUD~~ Monitoring of Interim Draws. The ~~HUD ORCF Construction Manager~~Lender will
320 monitor interim draws. If a problem is encountered during an interim draw, ~~they~~the
321 Lender will ~~bring~~present the problem and solution to the ~~Lender~~ORCF Construction
322 Manager, and, if necessary, ORCF Asset Management in order to:

323

324 1. Modify the next draw, or

325

326 2. Withdraw the Lender's authority to approve advances.

327

328 I. Disbursement of Grant/Loan Proceeds. Grant/loan proceeds may come either from a
329 governmental source, i.e., Federal, State, or local government agency or instrumentality, or a
330 nongovernmental source, e.g., a foundation.

331

332 1. General for Governmental/Nongovernmental Source Funds. The proceeds are
333 used to fund a front money cash escrow (Maximum Insurable Loan Calculation) at
334 initial closing, whether the funding source is a governmental or nongovernmental entity.
335 See paragraph 2 below for additional options to a cash escrow available to
336 governmental source entities only.

337 a. Disbursement priority of grant/loan proceeds in relation to mortgage
338 proceeds and other escrows is discussed in paragraph A.

339 b. Disbursement procedures from the cash escrow are discussed in paragraph
340 D.

341 c. Release of grant/loan proceeds may not be targeted to the completion of
342 specific onsite improvements.

343

344 2. Additional Options for Governmental Source Funds. Where the grant/loan proceeds come
345 from a governmental source, the Borrower may use instead of a cash escrow:

346

347 a. An unconditional irrevocable letter of credit issued by a banking
348 institution, or

349 b. An agreement entered into by HUD, the Lender, the Borrower and
350 the governmental entity for a pro rata disbursement of the loan/grant
351 proceeds.