

CHAPTER 1. PREPARATION FOR INITIAL CLOSING

1-1. PURPOSE.

- A. To Guide the Director of Housing Development (DHD) in reviewing documents for the initial closing for projects with insured advances. The DHD in this Handbook is the organizational position in each Regional office and Category A and B Field Office to which the Regulations, 24 CFR Part 200, Subpart D, and current administrative notices delegate the responsibilities of Chief Underwriter and/or Director of Housing Development.
- B. To Assist the Field Office Manager, Field Counsel and other HUD staff in preparing for and conducting the initial closing.

1-2. OBJECTIVE is to:

- A. Identify the Primary Parties and their responsibilities.
- B. Provide Instructions for addressing specific closing issues requiring special attention and to identify the initial closing documents.
- C. Achieve Speedy Competent Reviews and closing proceedings.

1-3. AUTHORITY AND RESPONSIBILITY FOR CLOSING.

- A. Field Office Manager (Regional Director of Housing performs all Field Office Manager initial closing functions for Regional Offices) is responsible for:
 - 1. Assuring that conditions of the commitment are met.
 - 2. Establishing the place, date, and time for the closing, and not permitting any rescheduling unless absolutely necessary.
 - 3. Notifying all parties.
 - 4. Endorsing the note and assuring its reasonableness.
- B. Field Office Chief Counsel is responsible for:
 - 1. Legal sufficiency of all closing documents.

- (1-3) 2. Conducting the closing, or where not possible:
- a. Assigning responsibility to another Field office attorney, or where not possible,
 - b. Notifying the Regional Counsel who may:
 - 1) Authorize travel for a Regional Counsel or Counsel from another Field Office to conduct the closing, or
 - 2) Arrange for a Headquarters' attorney to conduct the closing, where other alternatives are not available.
- C. Director of Housing Development is responsible for:
- 1. Recommending to the Field Office Manager the insurance of mortgages pursuant to commitments to insure.
 - 2. Establishing processing priorities and start of construction target dates, and monitoring schedules.
 - 3. Directing all activities essential to the insurance of mortgages, including approval of:
 - a. Findings of acceptability with respect to program policy and eligibility criteria,
 - b. Subordinates' preliminary underwriting determinations supporting insurance endorsements,
 - c. Nonprofit sponsors,
 - d. Housing consultants,
 - e. Eligibility statements,
 - f. Construction advances, and
 - g. Regulatory agreements.
 - 4. Coordinating crosscutting office support activities required for multifamily mortgage insurance.

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- (1-3) 5. Approval, cancellation or modification of reservations for contract authority required for subsidy payments.
6. Where necessary, exercising authorities and performing functions delegated by 24 CFR Part 200.112 to the Chief, Mortgage Credit.
- D. Chief of Mortgage Credit is responsible for establishing the financial requirements for closing.
- E. Mortgagor's Attorney is responsible for submitting two complete draft closing packages for HUD review 15 days before the tentative closing date. One is for the HUD closing attorney and the other for the DHD and technical disciplines.
1. Requirements for accepting the package for review include:
- a. All documents must be submitted at one time,
- b. Forms and exhibits must be completed, and
- c. The pro forma title policy included.
2. Requirements for scheduling the closing include review and approval of all closing documents by the HUD Closing Attorney and DHD.
- 1-4. CLOSING PLACE should be the Field Office, except where salient factors warrant another closing location within the field office jurisdiction. These may include project remoteness, e.g., where an office has multiple state jurisdiction. The HUD closing attorney is responsible for arranging accommodations identified by the Field Office Manager.
- 1-5. CLOSING DATE should be other than a Monday, Friday or date preceding or following a legal holiday. Give consideration for closings that may extend into a second day, and to provide all parties a full working day for last minute details before the closing.
- 1-6. CLOSING TIME should be early A.M. to permit:
- A. Surety Telegram to be sent twice, if required.
- B. Title Company to record the mortgage in the project's local jurisdiction on the closing day.
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- (1-6) C. Initial Draw of Loan Proceeds. Require evidence that the loan documents have been recorded and that they constitute a first lien on the entire property before permitting the advance of any loan proceeds. See Handbook 4435.1 REV 1 for details where the first draw occurs at initial endorsement.
- 1-7. FORMS REVISION. Do not change HUD/FHA forms discussed in this handbook, except as follows:
- A. Field Office Manager may approve nonsubstantive changes to any administrative form, if the changes are required by local law or procedures. All such changes must be identified in the Closing Attorney's Certificate in the Washington Docket.
 - B. HUD Closing Attorney may approve nonsubstantive changes to any legal form, if the changes are required by local law or procedures. All changes, including any made by the Field office Manager, must be identified in the Closing Attorney's Certificate in the Washington Docket.
 - C. Substantive Changes must be submitted to Headquarters for approval and must be supported by a recommendation from the Field Office Manager (administrative forms) or Counsel (legal forms). Submit requests 60 days before anticipated closings, as follows:
 - 1. Legal documents/issues to the Assistant General Counsel For Multifamily Mortgage Insurance.
 - 2. Administrative documents/development issues to the Office of Insured Multifamily Housing Development.
 - 3. Housing Management documents/issues to the Office of Multifamily Housing Management.
- 1-8. EARLY START/START OF CONSTRUCTION. Construction may not start before initial endorsement and recordation of the insured mortgage, except with the prior approval of the Field Office Manager. Any work performed after receipt by the Field Office of the initial application for mortgage insurance, including clearing, grading or other preliminary work, constitutes the start of construction in this regard. The following are mandatory conditions for approval of an early start of construction:

- (1-8) A. Firm Commitment. There must be a valid outstanding Firm Commitment, including a HUD approved set of contract drawings and specifications on file with HUD. See Handbook 4460.1 REV-1 for required firm commitment contract drawings and specifications.
- B. Valid Basis For Early Start. The Field Office Manager must document the file fully defining the rationale and compelling reason for granting an early start, after determining that:
1. An immediate closing is not practical.
 2. There is reasonable evidence and assurance that closing will occur in the near future.
 3. There is a compelling need to start construction before the anticipated closing date.
 4. An early start of construction will not be detrimental to HUD's interests.
 5. HUD has no insurance obligation or liability whatsoever for costs incurred during an early start if the project does not reach endorsement.
- C. Form FHA-2415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, must be executed without change by the contractor, mortgagor and mortgagee.
- D. Preconstruction Conference must be held before the start of any construction.
- E. Violations of Early Start Criteria must be referred to the Field Office Manager for a determination as to whether the project may proceed to initial endorsement.
- 1-9. INITIAL CLOSING FORMS AND DOCUMENTS are listed in Appendix 1, and must be used unless a substitute has been approved in writing by the Assistant General Counsel for Multifamily Mortgage Insurance. Appendices 2 through 5 provide technical discipline review sheets.
- A. Document Completion is generally self-explanatory. Exceptions are clarified in the following paragraphs.

(1-9) B. Draft Closing Package. Upon receipt from Field Counsel distribute the draft closing package to the housing program and technical discipline sections for document review and completion of the review sheets (Appendix 2 through 5).

1. Forward a copy of the review sheets to the HUD closing attorney.
2. Place the original review sheets in the Washington Docket and a copy in the Field Office Docket.

C. Executed Closing Documents.

1. Retain the original, duplicate original or executed copy of each document for the Washington Docket, except that a completely legible copy (certified true and correct) must be collected where the original is unavailable because of filing or recording requirements. See the Schedule of Washington Docket Documents, Handbook 4440.1.
2. Retain a conformed copy of each closing document for the Field Office Docket, except use duplicate originals or executed copies where available.

1-10. TITLE. Marketable title to the property must be vested in the mortgagor on the date the mortgage is recorded. See requirements of Mortgagee's Certificate, paragraph (3). Mortgagor must provide and HUD must review title documents for initial closing as follows:

- A. Field Office Manager must determine the acceptability of the mortgagor's proposed title company.
- B. HUD Closing Attorney is responsible for:
 1. Acceptability of the title,
 2. Identifying title conditions, covenants and restrictions that violate Federal statutes or regulations, or the regulatory agreement, and causing them to be eliminated from the title.
 3. Bringing any title conditions, covenants or restrictions, including air right provisions, leasehold contracts, and common use easements and maintenance agreements, to the Field Office Manager's and DHD's attention.

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- (1-10)C. Director Housing Development is responsible for:
1. The title policy amount being adequate to protect HUD interests.
 2. Assuring that any title exceptions do not adversely affect project value or marketability, or where a clear determination cannot be made, refer the exception to Headquarters, Office of Insured Multifamily Housing Development.
 3. Assuring that the proposed construction contract documents and other contractual obligations call for the project to be constructed and managed consistent with the project's legal restrictions and covenants.
- D. Title Evidence. The mortgagee must provide a policy of title insurance, surveyor's certificate and survey of the covered property that are acceptable to HUD. The Field Office Manager may accept an alternative to a title policy in accordance with paragraph F. below, where satisfied after consulting with Field Counsel that a title policy cannot be furnished. Any required policy of title insurance evidence of title, survey or surveyor's certificate must be furnished without expense to HUD.
- E. Title Insurance Policy must be issued by a title company acceptable to HUD in the ALTA format approved by HUD, and:
1. Names the mortgagee and Secretary of HUD as the insured parties as their interests may appear.
 2. Provides that, upon acquisition of title by the mortgagee or Secretary, it will become an owner's policy running to the mortgagee or the Secretary, as the case may be. (Regulation change pending.)
 3. Shows the insured mortgage as the first lien.
 4. Shows no liens other than the insured mortgage and any other liens that the Secretary of HUD approves.
- F. Alternate Evidence of Title. Where acceptable to the Field Office Manager, as provided in paragraph D. above, the mortgagee may use one of the following types of title evidence:
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- (1-10)
1. Abstract of title acceptable to HUD, prepared by an abstract company or person engaged in the business of preparing abstracts of title, accompanied by a legal opinion satisfactory to HUD, as to the quality of such title, signed by an attorney-at-law experienced in the examination of titles;
 2. A Torrens or similar title certificate; or
 3. Evidence of title conforming to the standards of a supervising branch of the Government of the United States of America, or of any State or Territory thereof.
- G. Surveyor's Certificate, Form HUD-92457, signed within 30 days before initial closing by a licensed surveyor and bearing the surveyor's professional seal.
- H. Survey. Require the survey map(s) to be certified as described on the back of the Surveyor's Certificate, Form HUD-92457, dated, signed and sealed within 90 days before initial closing.
1. The Field Office Manager may permit substitution of paragraph a. below for the Form HUD-92457 requirement, "The certificate should be addressed, to wit: 'To all parties interested in title to premises surveyed,'" where the Form HUD-92457 requirement causes unwarranted legal difficulties or liability insurance costs. The certificate must also include paragraphs b. and c. below.
 - a. "I hereby certify to the U.S. Department of Housing and Urban Development (HUD), (Borrower), (Sponsor), (Lender), (Title Insurance Underwriter), (other), and to their successors and assigns, that:"
 - b. "I made an on the ground survey per record description of the land shown hereon located in city or town, county, township, etc.), on (date); and that it and this (these) map(s) was (were) made in accordance with the HUD Survey Instructions and Certificate, Form HUD-92457, meet the requirements for a Class A Survey, as defined in the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Survey," dated 1988, and meet or exceed the accepted professional practices for land title, topographic and utility surveys and maps for
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- (1-10) the design and construction of multifamily housing projects in the jurisdiction where the project is located."
- c. "To the best of my knowledge, belief and information, except as shown hereon: There are no encroachments either way across property lines; title lines and lines of actual possession are the same; there are no high pressure gas or hazardous liquids transmission lines, as defined by Title 49 Parts 192 and 195 of the Code of Federal Regulations, across or within 220 yards of the premises at the nearest point; and the premises are free of any (subject to a) 50/100/500 year return frequency flood hazard, and such flood free (flood) condition is shown on the Federal Flood Insurance Rate Map, Community Panel No. (state, if none)."
2. Require a three dimensional air rights map for air rights projects. Verify the existence of adequate vertical ways to the ground for required services, e.g., utility and fire suppression lines, chimneys, trash chutes, elevators and emergency exit stairs. Assure that there is an acceptable discharge to a public way from all building egresses, including emergency exits, and services, e.g., trash removal.
- I. Maintenance Agreements. Require mortgagor to provide for recordation a maintenance agreement for all common use facilities, e.g., common drives; common lobbies, parking structures, or other air rights project common facilities; etc.
1. Assure that the integrity and maintenance of air rights platform foundations and other structural members are defined as the air rights provider's responsibility.
2. Verify that shared maintenance/operating costs are equitable and that enforcement rights protect the project interests.
- 1-11. LEASEHOLDS must conform to the FHA Lease Addendum Form FHA-2070.

- (1-11)A. Term of The Lease Addendum may be varied to conform with applicable State and local law, except that the HUD closing attorney must approve:
1. The legal need for any proposed lease term changes, and
 2. That any term changes are consistent with the regulations for the Section of the Act under which the project is underwritten.
- B. Sections 207, 213, 220 and 231. The lease term must satisfy one of the following requirements (24 CFR Section 207.23(a), 213.40(a), 220.501, 231.1):
1. Term is 99 years and is renewable,
 2. Term is at least 75 years from the date the mortgage is executed, or
 3. Term is at least 50 years from the date the mortgage is executed and the lessor is a governmental agency, an Indian, an Indian tribe, or other lessor the FHA Commissioner approves.
- C. Sections 221(d) and 236. The lease term must satisfy one of the following requirements (24 CFR Section 221.544(a), 236.1):
1. Term is 99 years and is renewable, or
 2. Term has at least 10 years to run after maturity date of the mortgage.
- D. Section 232. The lease term must satisfy one of the following requirements (24 CFR Section 232.25a(b) through (d)):
1. Term is at least 99 years and is renewable,
 2. Term is at least 55 years from the date the mortgage is executed, or
 3. Term is at least 50 years from the date the mortgage is executed and the lessor is a governmental agency, an Indian, an Indian tribe, or such other lessor as the FHA Commissioner approves.

- (1-11)E. Section 242. The lease term must satisfy one of the following requirements (24 CFR Section 242.87(b) and (c)).
1. Term is at least 99 years and is renewable, or
 2. Term is at least 50 years to run from the date the mortgage is executed.
- F. Changes Other Than Lease Term must be recommended by the Field Office Manager and approval by Headquarters, Office of Insured Multifamily Housing Development.
- 1-12. AIR RIGHTS PROJECTS. Initial endorsement must be deferred until the air rights platform is complete and ready for work to start on the project. See paragraphs 1-10.D.2. and 1-10E. above.
- 1-13. OWNER-ARCHITECT AGREEMENT must be on AIA Document B181, Standard Form of Agreement Between Owner and Architect for Housing Services, and the HUD Amendment, Appendix 6, must be included as a rider. See Handbook 4460.1 REV-1 for additional information.
- A. Architect is any architect, engineer or designer that:
1. Is registered to provide the proposed project services in the State in which the project is located.
 2. Serves as a prime architect, i.e., provides directly to the Owner any or all of the basic architectural services. See Appendix 6, paragraph 2.
- B. Multiple Prime Architects, exist when the owner contracts directly with two or more architects to provide the basic architectural services.
1. Require separate Owner-Architect Agreements for each prime architect. Each must clearly define the specific services covered, and fees.
 - a. Modify the standard services, where applicable, in Article 10, or at the applicable Article.
 - b. Basic fees must be a lump sum, i.e., fixed price.

- (1-13)
2. Separate design and supervisory architects are acceptable. Where a separate architect is employed for construction phase services, the Owner-Architect Agreement for the supervisory architect must be submitted 15 days before initial closing.
 3. Owner-Architect Agreements for the supervisory and design architect(s) must be shown in the construction contract for the respective services.
- C. Supervisory Architect may not have an identity of interest, as defined in Appendix 6, with the mortgagor or contractor. Determine that the HUD addendum to the Owner-Architect Agreement, Appendix 6, has been included as a contract rider and that no identities of interest are listed.
- D. Owner Furnished Services for land surveys, geotechnical reports, lead-based paint hazard testing, and similar specialty engineering and laboratory services that are not basic architectural services need not be contracted through use of AIA Document B181.
- E. Fee Claims.
1. Require mortgagor to certify that there are no unpaid fees or claims for architectural, engineering, testing, or related services performed for the project by other than those identified on the certification and in the amount shown. See Appendix 7.
 2. Article 8.4 of the Owner-Architect Agreement supersedes any agreement or arrangement between the mortgagor and architect(s) of record predating contract execution, and must not be voided.
- F. Fee Payment must be made as follows:
1. Design and design related services must be paid before or at initial closing. If the fee for such services is in dispute at the time of initial closing, the mortgagor may post a cash escrow with the mortgagee in the full amount of any disputed claim or in such lesser amount acceptable to the Field Office Manager.
 2. Supervisory services payment must be based upon the monthly work progress, and may not exceed a rate equal to the percentage of project completion.
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- (1-13) 3. The Owner-Architect Agreement must separately identify the fee for design and supervisory services, where both are provided by the same entity.
- G. Mortgagor's and Architect's Certificate, Form HUD-92403-1, must be executed at or before initial endorsement for each prime design professional. Do not approve draws in the Application for Insurance of Advance of Mortgage Proceeds, Form HUD-92403, exceeding the amount certified on Form HUD-92403-1.

1-14. CONSTRUCTION CONTRACT.

- A. Form HUD-92442, Construction Contract - Lump Sum. Use only where no identity of interest exists between the mortgagor and the general contractor or any subcontractor, material supplier or equipment lessor, and the mortgagor is:
1. Public, limited distribution, investor-sponsor, or general, or
 2. Nonprofit using competitive bidding for award of the general construction contract.
- B. Form HUD-92442A, Construction Contract - Cost Plus, may be used in any case, and must be used where:
1. An identity of interest exists between the mortgagor and the general contractor or any subcontractor, material supplier or equipment lessor,
 2. Mortgagor is a nonprofit entity, except that a nonprofit entity may use a lump sum contract where the project is competitively bid, or
 3. Mortgagor is a builder-seller, except that a builder-seller may use a lump sum contract where the Field Office Manager determines that a cost plus contract is not required to protect HUD's or the mortgagor's interests. The Field Office Manager must document the Field Office and Washington Dockets of such approval.
- C. No Construction contract is required where the mortgagor elects to be its own contractor, if:

- (1-14)
1. Mortgagor-Contractor is an individual, joint venture, tenancy in common or partnership in which all partners are general partners,
 2. Assurance of completion is provided as defined in paragraph 1-16, and
 3. The Supplement to Building Loan Agreement, Form FHA-2441-Sup, and the Mortgagor's and/or Contractor's Cost Breakdown, Form HUD-92328, are used in place of the standard contract.
- D. Identity of Interest Between Owner and Contractor. Require execution of the HUD Addendum to the Contract, Appendix 8, for both the Lump Sum and Cost Plus Contracts, Forms HUD-92442 and HUD-92442A respectively. List the addendum in the Scope of Contract, Article 1.
- E. Contract Completion Date entered in Article 2.A. for either the Cost Plus or Lump Sum Contract:
1. Must not be later than the date computed by adding the construction time specified in Form HUD-92264, Part G, Line 52, to the contract execution date.
 2. May be earlier than the computed date where agreed to by the mortgagor, contractor and HUD.
 3. Should not occur during a holiday or weekend.
- F. Liquidated Damages entered in Article 2.C. for either the Cost Plus or Lump Sum Contract must be computed as follows:
1. Nonprofit Hospitals--require a daily liquidated damage amount equal to 18 cents per thousand dollars of mortgage where the construction loan interest rate is 6 percent or less. Increase the daily liquidated damage amount one cent per thousand dollars of mortgage amount for every 1/4 percent the construction loan interest rate exceeds 6 percent.
 2. All other projects--require daily liquidated damages of one cent per thousand dollars for every 1/4 percent of the construction loan interest rate.
 3. A larger amount may be used, if agreed to by both mortgagor and contractor.
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- (1-14) 4. Liquidated damages do not apply to an Owner-Contractor. See paragraph 1-14.C. above.
- G. Contract Amount and Form HUD-92283, Financial Requirements for Closing, Line 4, must agree.
- H. Contractor's and/or Mortgagor's Cost Breakdown, Form HUD-92328, must be attached as an exhibit to the Contract.
- I. Payment For Components Stored Offsite. Where payment for components stored offsite is approved, require:
1. The Amendment to the Construction Contract for Payment for Components Stored Offsite, Appendix 9, as a rider to the Contract.
 2. Mortgagor to provide assurance of completion of on-site improvements in the form of corporate surety bonds in accordance with paragraph 1-17.A.
 3. Mortgagee to agree to;
 - a. File Uniform Commercial Code (UCC)-1, financing statements with the proper office in the proper jurisdiction.
 - b. Make whatever additional filings are necessary to maintain a first lien on the components until they are incorporated into the building(s).
 - c. Release the financing statement filings as appropriate.
 - d. Unconditionally certify by letter to HUD that the security instrument(s) is (are) a "first lien" on the building components covered by the instrument(s). The mortgagee's certification must be supported by an opinion from the mortgagee's counsel.
 - e. In the event of default under the mortgage, either assign its security interest to HUD or acquire title through foreclosure to the components intended for use or incorporation into the building(s) and convey title to HUD.

Note: Handbook 4435.1 REV-1 defines eligible components for offsite storage.

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(1-14)J. Contract Execution. The HUD closing attorney is responsible for: determining use of a lump sum or cost plus contract, contract acceptability, and contract execution based on the Agreement and Certification, Form HUD-3305 (Insurance of Advances-no profit and risk allowance), Form HUD-3305A (Insurance Upon Completion - no profit and risk allowance), Form HUD-3306 (Insurance of Advances-with profit and risk allowance) or Form HUD-3306A (Insurance Upon Completion-with profit and risk allowance).

1-15. CONSTRUCTION CONTRACT INCENTIVE PAYMENT is an option that the mortgagor may elect to use as a contractor inducement for early contract completion. It may not, however, be added to the construction contract after initial endorsement. Handbook 4470.1 REV-1 contains additional instructions.

A. Nonidentity of Interest Mortgagors. Use Form HUD-92443, Construction Contract Incentive Payment, which includes instructions for modifying both the Lump Sum and Cost Plus construction contracts, Forms HUD-92442 and HUD-92442A respectively. See paragraphs 1-14.A. and B. for when each form of contract may/must be used.

B. Identity of Interest/Profit Mortgagor. Permit modification of the Construction Contract-Cost Plus, Form HUD-92442A, to offset construction cost overruns with soft cost savings at cost certification where the actual contract completion occurs before the specified contract completion date.

1. Soft costs are the mortgagor's construction interest, taxes, insurance, and Mortgage Insurance Premium (MIP). Soft cost savings resulting from early contract completion may be used to increase the general contractor's cash upset figure up to the HUD recognized construction cost overruns.

a. Pay special attention to the reasonableness of the HUD construction time estimate where this procedure is used.

b. Do not include cost overruns caused by the general contractor's inefficiency or waste in the HUD recognized cost overrun amount at cost certification.

2. Contract Modification Language for projects:

- a. Where construction contract incentive payment is permitted, insert the following provision directly after the cash upset figure in Article 3A.(1), Form HUD-92442A.

"plus the amount by which \$ _____ (the estimated sum of mortgage interest, taxes, and property insurance and mortgage insurance premiums applicable to the construction period for this project) exceeds the mortgagor's certified actual cost for these items through the date of final completion, as approved by the Commissioner, provided that construction is completed prior to the date specified in Article 2A of the Construction Contract, as amended by approved change orders, and, further, that in no event shall the total cash payable exceed the actual cost of construction as approved by the Commissioner."

- b. Where mortgagee will sell bonds to finance the construction loan, as in the case of a State Housing Agency, and the true interest rate will not be known until cost certification, insert the following provision directly after the cash upset figure in Article 3A.(1), Form HUD-92442A.

"plus the amount by which \$ _____ (the estimated sum of mortgage interest, taxes, property and mortgage insurance premiums applicable to the construction period for this project) exceeds the mortgagor's certified actual cost for these items through the date of final completion, as approved by the Commissioner, provided that construction is completed prior to the date specified in Article 2A of the Construction Contract and, further, that in no event shall the total cash payable exceed the actual cost of construction as approved by the Commissioner. If the aggregate interest rate during the construction period is determined at the time of cost certification to be less than that upon which the mortgage note was

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- (1-15) endorsed, the estimated amount for interest, Form HUD-92264, Line 53, shall be adjusted accordingly and the dollar amount set forth above shall be reduced."
- c. Cost overruns at cost certification may be offset with soft cost savings realized by the contractor's early contract completion, only if the provisions in paragraph a. or b. above have been included as a construction contract rider by initial closing.
3. Soft cost computation. Insert in the added contract provisions, paragraphs B.2.a. and B.2.b. above, the sum for interest, real estate taxes, property insurance, and MIP estimated for the construction period by prorating the respective amounts from Form HUD-92264, Lines 53, 54, 55, and 56 as follows:
- a. Multiply Lines 53, 54 and 55 times the fraction $M/M+2$ respectively for interest, real estate taxes and property insurance premium addends; and multiply Line 56 times the fraction $M/Yx12$ for the mortgage insurance premium addend, where:
- 1) M equals the cost analyst's estimated construction time in months shown on Form HUD-92664, Line 52, and
 - 2) Y equals the number of whole years for which MIP was computed on Form HUD-92264.
- b. The proration is required, because on Form HUD-92264, interest, real estate taxes and property insurance premiums are computed for two months longer than the estimated construction period, and MIP is computed by rounding the construction period up to whole years.
- C. Owner-Contractor. Permit a rider to the Supplement to Building Loan Agreement, Form FHA-2441-Sup, and Mortgagor's and/or Contractor's Cost Breakdown, Form HUD-92328, where the Owner acts as its own contractor (See paragraph 1-14.C. above). The rider must be as provided in paragraph 1-15.B. above.

- 1-16. ASSURANCE OF COMPLETION must be provided for on-site improvements as provided by paragraph 1-17. below, and for offsite improvements as provided by paragraph 1-18. below. All types of assurance of completion must be on HUD approved forms.
- A. HUD Closing Attorney must review each type of assurance of completion, including the form of bonds where used, for legal sufficiency and compliance with applicable State requirements.
 - B. Letters of Credit may be used instead of cash for certain assurances of completion and escrows required at initial and final endorsement, or during construction.
 - 1. Where permitted, acceptance of a letter of credit is the mortgagee's option. The letter of credit must always be:
 - a. Unconditional and irrevocable.
 - b. Issued by a banking institution.
 - c. Valid and collectible.
 - 2. The mortgagee may not be the issuer of any letter of credit without prior written consent of the Office of Insured Multifamily Housing Development.
 - 3. Do not render an opinion on the letter of credit at closing as enforceability is the mortgagee's sole responsibility.
- 1-17. ASSURANCE OF COMPLETION FOR ON-SITE IMPROVEMENTS must be provided by the general contractor for HUD's protection and to meet State/local requirements to protect material suppliers and mechanics or to assure contractor or subcontractor payment. See requirements of Mortgagee's Certificate, paragraph (9). The mortgagee or mortgagor may impose higher requirements, but must require one of the following as a minimum:
- A. Corporate Surety Bonds. Use Form FHA-2452 for payment bonds and Form FHA-2452A for performance bonds, each equalling 100 percent of the HUD estimate of construction or rehabilitation cost. Require corporate surety bonds for the assurance of completion of on-site improvements where payment for components stored

offsite is approved.

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1. Surety must be on the accredited U.S. Treasury list, Circular 570, published annually in the Federal Register on or about July 1, and
 2. The bonds must not exceed limits listed in the circular.
 3. Mortgagee and HUD must be shown as payee as their interests appear.
- B. Completion Assurance Agreement-15 Percent Cash Security Deposit. Use Form FHA-2450, secured by a cash deposit (or unconditional, irrevocable letter of credit) for 15 percent of the HUD estimate of construction or rehabilitation cost (See paragraph C.). Applicable only to projects where:
1. Structure contains no elevator, or
 2. Structure contains an elevator but is three stories or less, or
 3. Financing is under Section 241, Supplemental Financing for Insured Project Mortgages, and there is no personal indemnity agreement.
- C. Completion Assurance Agreement-25 Percent Cash Security Deposit. Use Form FHA-2450, secured by a cash deposit (or unconditional irrevocable letter of credit) for 25 percent of the HUD estimate of construction or rehabilitation cost (See paragraph G.). Applicable where the project includes an elevator and is four or more stories.
- D. Personal Indemnity Agreement may only be used where:
1. The HUD estimate of construction or rehabilitation is \$500,000 or less,
 2. Form FHA-2459, Personal Undertaking, is signed individually by the controlling principals (i.e., all principal officers, directors and stockholders, or partners, or individual) acting as general contractor, and their spouses, and
 3. All controlling principals are acceptable to HUD.

- E. No Assurance of completion is required where financing is for rehabilitation under Section 221(d)(3), Section 221(h), Section 235(j) or Section 236, and:

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- (1-17) 1. The project consists of 11 or less units.
2. The mortgagor or contractor are not involved in concurrently rehabilitating more than two such projects.
- F. Mortgagor-Contractor Without Construction Contract. See paragraph 1-14.C. for eligibility criteria. Require assurance of completion as defined in paragraphs 1-17.A. through E. above, except substitute Forms FHA-3452 and FHA-3452A for Forms FHA-2452 and FHA-2452A respectively, where corporate surety bonds are used.
- G. HUD Cost Estimate For Determining Surety Amount.
1. BSPRA projects.
- a. Deduct the architect's fee from the "total for all improvements," Form HUD-92264, Line 50.
- b. Add to the amount computed in step 1.a. a typical builder's profit, but no general overhead.
2. Non BSPRA projects--Use only step 1.a. above.
- 1-18. ASSURANCE OF COMPLETION FOR OFFSITE IMPROVEMENTS. See requirements of Mortgagee's Certificate, paragraphs (7) and (8). Require one of the following:
- A. Public Body Agreement acceptable to HUD from the controlling jurisdiction giving assurance for installation of utilities, streets or other facilities without cost to the mortgagor. Require mortgagor's attorney's opinion that the agreement is binding on the public body and succeeding administrations.
- B. Cash Escrow (use Form FHA-2446, Escrow Agreement for Offsite Facilities) deposited with the mortgagee, a trustee or an escrow agent acceptable to HUD, or an unconditional irrevocable letter of credit (see paragraph 1-16.B.). The amount must equal or exceed HUD's estimate of cost of offsite facilities.

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- (1-18)C. Retention of Specified Mortgage Proceeds By Mortgagee may be used only when cash available to the mortgagor, as shown in line 42 of Form FHA-2283, equals or exceeds the estimated offsite construction costs plus the lesser of HUD's "as is" estimate of value, or the actual latest arm's length purchase price. Where additional assurance is deemed necessary, require:
1. Form FHA-2479, Offsite Bond, or
 2. A letter of credit in accordance with paragraph 1-16.B above.
- 1-19. HAZARD INSURANCE POLICY. The mortgagee is responsible for insurance compliance per the Mortgagee's Certificate, paragraph (17). Mortgagor must provide hazard insurance and the policy(ies) must contain a loss payable clause with the mortgagee, HUD and the contractor named as their interests may appear. The mortgagor may elect or the mortgagee may require a higher amount, but the insurance must at least equal 100 percent of the replacement value of structures as determined by HUD. See Handbook 4450.1 REV-1.
- A. Property Insurance Requirements and Schedule. Mortgagor must provide an original and one copy of Form FHA-2447, Property Insurance Requirements with Form HUD-92329, Property Insurance Schedule-Insurable Values for Property Insurance Coverage attached.
 - B. Effective Coverage Date. Require the Property Insurance Requirements, Form FHA-2447, to bear the Mortgage (or Deed of Trust) Note date.
- 1-20. MORTGAGE (OR DEED OF TRUST). Must be a first lien on the entire property. Where permitted by the Section of the Act under which the project is insured, e.g., Section 232 and Section 221(d) SRO projects, the property includes all nonrealty equipment and furnishings whether financed by mortgage proceeds or sponsor's funds. The property also includes major kitchen appliances financed from mortgage proceeds in projects insured under other sections of the Act.
- A. Mortgage (or Deed of Trust) Form must be that approved by the Assistant General Counsel for Multifamily Mortgage Insurance for the Field Office/State jurisdiction in which the project is located.
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- (1-20)B. Security Agreement and Financing Statement. Use the appropriate Uniform Commercial Code documentation (Chattel Mortgage where applicable) as the security instrument for nonrealty equipment and furnishings in accordance with State/local requirements. See the Mortgagee's Certificate, paragraph (12).
1. The documents must be filed as specified by State/local law, which may include: the appropriate local court, Secretary of State, State corporation commission, etc.
 2. Attach a property description (list(s) of major movable equipment) to the financing statement covering all the nonrealty equipment and furnishings covered.
- C. Liens. The property, including any nonrealty equipment and furnishings covered by the mortgage, must be free and clear of all liens other than the insured mortgage and any other liens that HUD approves.
- D. Standard Exculpatory Language for the Mortgage (or Deed of Trust).
- "Notwithstanding any other provision contained herein or in the Note, it is agreed that the execution of the Note shall impose no personal liability upon the mortgagor for payment of the indebtedness evidenced thereby and in the event of a default, the holder of the Note shall look solely to the property subject to this Mortgage and to the rents, issues and profits thereof in satisfaction of the indebtedness evidenced by the Note and will not seek or obtain any deficiency or personal judgment against the mortgagor except such judgment or decree as may be necessary to foreclose or bar its interest in the property subject to this Mortgage and all other property mortgaged, pledged, conveyed or assigned to secure payment of the Note; provided, that nothing in this condition and no action so taken shall operate to impair any obligation of the maker under the Regulatory Agreement herein referred to and made a part hereof."
- E. Attorney's Opinion. Require mortgagor's attorney to provide an opinion as to the legal sufficiency of the security instrument(s). See paragraph 1-37.
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- 1-21. MORTGAGE (DEED OF TRUST) NOTE must be in the form approved by the Assistant General Counsel for Multifamily Mortgage Insurance for the Field Office/State jurisdiction in which the project is located. Identify the section of the Act under which the mortgage is insured on the panel of the Note.
- A. Term must be the same as included in the firm commitment, except that the maximum and minimum term must also meet the following:
1. New construction or substantial rehabilitation projects--term may not exceed the lesser of 40 years or 75 percent of the project's remaining economic life.
 2. Existing project (insured under either Section 207 or Section 232 pursuant to Section 223(f))--term must not be less than 10 years nor exceed the lesser of:
 - a. 35 years (40 years if the project meets the additional eligibility requirements for a mortgage refinancing a project financed with State or local assistance, or financing a project in a Target Preservation Area), or
 - b. 75 percent of the estimated remaining economic life of the physical improvements (100 percent if the project meets the additional requirements for a mortgage financing a project in a Target Preservation Area).
 3. The mortgage term starts on the date of the originally scheduled commencement of amortization.
- B. Prepayment Provisions. Except as specifically permitted in paragraphs 3. through 5. below, the Note must contain the following prepayment provisions:
1. Proprietary (For-Profit) Facilities.
 - a. Prepayment must be permitted in whole or in part so long as 30 days advance written notice is given to the mortgagee of intent to prepay, except as provided in paragraph 5. below.

- (1-21) b. Prepayments must be permitted for up to 15 percent of the original principal amount in any one calendar year without a prepayment charge. Prepayments exceeding 15 percent may be subject to a charge agreed to by the mortgagor and mortgagee and included in the mortgage.
2. Nonprofit Facilities.
- a. Upon prior consent of the Commissioner, the mortgage debt may be prepaid in full.
- b. The Commissioner may approve partial payments to reduce succeeding monthly payments over the remaining portion of the original mortgage term.
- c. The Commissioner may also approve partial prepayments made after 30 days written notice. Prepayments exceeding 15 percent of the original principal amount may be subject to a reasonable charge on such excess agreed to by the mortgagor and mortgagee and included in the mortgage.
3. State and Local Bond Financed Projects. Subject to compliance with paragraph C. below, projects funded from tax-exempt or taxable bonds issued by State or local governmental bodies may include the following prepayment restrictions and prepayment penalty charges:
- a. Prepayment restriction period (lockout) must not exceed 10 years plus the construction period stated in the construction contract, and
- b. Prepayment penalty may be charged after expiration of the lockout stated in paragraph a. above, provided the charge:
- 1) During the first year following the lockout does not exceed 5 percent of the original mortgage,
- 2) Declines on a straight-line basis, and
- 3) Does not exceed 1 percent at the end of the fifth year following the lockout.

- (1-21) 4. Other Bond Obligations or GNMA Mortgage-Backed Securities. "Other bond obligations" refers to any agreement under which the insured mortgagee has obtained the mortgage funds from third party investors and has agreed in writing to repay such investors at a stated interest rate and in accordance with a fixed repayment schedule. Mortgages funded with the proceeds of GNMA Mortgage-Backed securities or "other bond obligations" may include the following prepayment restrictions and prepayment penalty charges, subject to compliance with paragraph D. below.
- a. A lockout not to exceed 10 years plus the construction period stated in the construction contract; or
 - b. A penalty charge provided the charge:
 - 1) Does not exceed 3 percent at the end of the first year following the construction period stated in the construction contract,
 - 2) Declines on a straight-line basis, and
 - 3) Does not exceed one percent at the end of the 10th year following the construction period stated in the construction contract; or
 - c. A combination lockout and penalty charge in which:
 - 1) The lockout period does not exceed 10 years plus the construction period stated in the construction contract, and
 - 2) The prepayment penalty does not exceed 1 percent at the end of the tenth year following the construction period stated in the construction contract.
5. Other Mortgages.
- a. Do not permit any prepayment lockout provisions, except where required by HUD regulations to hold certain types of rentals available, e.g., for Section 223(f), and Section 231.
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- (1-21) b. Do not permit any prepayment penalties, except that a Section 241 mortgage of \$200,000 or less may include a prepayment penalty provision for any prepayment in a single calendar year that exceeds 15 percent of the original mortgage amount, where:
- 1) Penalties do not exceed 3 percent during the first year of the mortgage term, or 10 percent where the conditions in paragraph D below are met,
 - 2) Penalties decline on a straight-line basis, and
 - 3) Penalties do not exceed 1 percent at the end of the tenth year following the construction period in the construction contract.
- C. Conditions For Including Lock-outs and/or Penalties. Require compliance with the following conditions when permitting prepayment lockouts and/or penalties under provisions of paragraph 1-21.B. above.
1. Rider to the Note. Include the following language, allowing HUD to override the prepayment lockout and/or penalty provisions in the event of a default:

"Notwithstanding any prepayment prohibition imposed and/or penalty required by this Note with respect to prepayments made prior to _____, 19 ____, enter first date on which prepayments may be made with a penalty of 1 percent or less the indebtedness may be prepaid in part or in full without the consent of the mortgagee and without prepayment penalty if HUD determines that prepayment will avoid a mortgage insurance claim and is, therefore, in the best interest of the Federal Government."
 - a. Require the rider to the Note as a condition of permitting lockouts for "State and Local Bond Financed Projects," paragraph B.3. above, and "Other Bond obligations or GNMA Mortgage-Backed Securities," paragraph B.4. above.

- (1-21) b. Require the rider to the Note as a condition of permitting prepayment penalties that initially exceed 3 percent in any project.
2. Rider to the Mortgagee's Certificate. Require the mortgagee to certify that in the event of a default during the term of the prepayment lockout and/or penalty (i.e., prior to the date on which prepayment may be made with a penalty of one percent or less), it will:
- a. Request a 3-month extension of the deadline prescribed by 24 CFR Section 207.258 for filing a notice of its intention to file an insurance claim and its election to assign the mortgage;
 - b. Assist the mortgagor arrange refinancing to cure the default and avert an insurance claim, if HUD grants the requested (or shorter) extension of the notice filing deadline;
 - c. Report to HUD at least monthly on any progress in arranging a refinancing;
 - d. Otherwise cooperate with HUD in taking reasonable steps to avoid an insurance claim;
 - e. Require any successors or assigns to certify in writing that they agree to be bound by these conditions for the remainder of the term of the prepayment lockout and/or penalty period.
 - f. Notify HUD of the delinquency where a payment is not received by the 16th day of the month in which it is due.
- D. Late Charge Provisions. The mortgagee may collect a late charge for the cost of handling delinquent payments, subject to the following:
- 1. Charges must not exceed two cents per dollar of principal and interest in arrears more than 15 days.
 - 2. Late charges must be separately charged to and collected from the mortgagor and cannot be deducted from any total monthly mortgage payment, or collected from any reserve escrow, residual receipts funds, or from any interest accruals thereto.
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- (1-21)E. Standard Exculpatory Language for the Mortgage (or Deed of Trust) Note.

"Notwithstanding any other provision contained in this Note, it is agreed that the execution of this Note shall impose no personal liability on the maker hereof for payment of the indebtedness evidenced hereby and in the event of a default, the holder of this Note shall look solely to the property described in the Mortgage and to the rents, issues and profits therefore in satisfaction of the indebtedness evidenced hereby and will not seek or obtain any deficiency or personal judgment against the maker hereof except such judgment or decree as may be necessary to foreclose and bar its interest in the property and all other property mortgaged, pledged, conveyed or assigned to secure payment of this Note except as set out in the Mortgage of even date given to secure this indebtedness."

- 1-22. SECOND MORTGAGE ON THE PROJECT may be used to secure repayment of a Federal, State or local government agency or instrumentality loan for its construction, subject to: review and approval requirements defined in Handbook 4470.1 REV-2, availability of surplus cash or residual receipts for its payment, and inclusion of the following provision in the second note:

"So long as the Secretary of Housing and Urban Development or his/her successors or assigns, are the insurers or holders of the first mortgage on (insert project name and FHA Project No.), payments due under this Note shall be payable only from surplus cash (or residual receipts) of said project, as the term surplus cash (or residual receipts) is defined in the Regulatory Agreement dated between HUD and (insert name of mortgagor). The restriction on payment imposed by this paragraph shall not excuse any default caused by the failure of the maker to pay the indebtedness evidenced by this Note."

- 1-23. BUILDING LOAN AGREEMENT, FOR HUD-92441. See Mortgagee's Certificate, paragraph (2). Set out the responsibilities, conditions, and operating terms between the mortgagee and mortgagor, including the basis under which insured advances may be made during the construction period. Also use the Supplement to Building Loan Agreement, Form FHA-2441-SUP, where an Owner-Contractor uses no construction contract. See paragraph 14.C. above.
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- 1-24. REGULATORY AGREEMENT must be incorporated into the mortgage by reference for regulation of the mortgagor. The Regulatory Agreement must be on a form approved by HUD for use by the mortgagor. The Agreement establishes the mortgagor's obligations in project operations and the lender's and HUD's rights if violated.
- A. Health Care Facilities. Where a project is leased to a residential care facility operator, the lessee must also execute a Regulatory Agreement, Form-92466-NHL.
- B. Manufactured (Mobile) Home Parks. Make the following modifications to the Regulatory Agreement, Form FHA-2466, when used for manufactured home parks.
1. Strike paragraph 2. in its entirety and substitute the following paragraph: "2. This agreement covers a manufactured home park. The terms 'dwelling,' 'housing,' 'units,' 'accommodations,' or similar references shall be construed to refer to 'manufactured home spaces.'"
 2. Strike paragraph 4.(a) in its entirety and substitute the following new paragraph: "4.(a) Owner shall make manufactured home spaces and services of the project available to occupants at charges not exceeding those established in accordance with a rent schedule approved in writing by the Commissioner, which charges shall provide reasonable rentals and a reasonable return to the mortgagor on its investment. Such accommodations shall not be rented for a period of less than thirty (30) days. Commercial facilities, if any, shall be rented at not less than the rate approved by the Commissioner. Subleasing of manufactured home spaces, except for subleases of single manufactured home spaces by the tenant thereof, shall be prohibited without prior written approval of the Owners and the Commissioner and any lease shall so provide. Upon discovery of any unapproved sublease, Owners shall immediately demand cancellation and notify the Commissioner thereof. Owner shall not use any spaces or other project facilities for manufactured home sales, nor rent manufactured homes with the spaces."

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- (1-24)C. Additional Restrictions may be imposed by the Field Office Manager with prior approval from the Headquarters Office of Insured Multifamily Housing Development and Assistant General Counsel for Multifamily Mortgage Insurance, where the additional requirements do not conflict with program criteria.
- 1-25. MORTGAGEE'S CERTIFICATE, FORM FHA-2434. Verify that all required escrows, deposits, fees and other amounts are properly reflected in the Mortgagee's Certificate. The closing attorney is responsible for the acceptability and proper execution of the Certificate.
- 1-26. WORKING CAPITAL DEPOSIT. Require a cash escrow or letter of credit of not less than 2 percent of the mortgage (lender may require more) at initial endorsement for proprietary mortgagors. The deposit is not required for nonprofit or public mortgagors under Sections 207, 220, 221, 231, 232, or 242 for which AMPO (paragraph 1-27) is required. See the Mortgagee's Certificate, paragraph (6)(a).
- 1-27. ALLOWANCE TO MAKE PROJECT OPERATIONAL (AMPO) must be included in the replacement cost and reflected in the Building Loan Agreement for nonprofit or public mortgagors under Sections 207, 220, 221, 231, 232, and 242, instead of establishing a working capital deposit. Require 2 percent of the mortgage. See the Mortgagee's Certificate, paragraph (6) (b).
- 1-28. ASSURANCE OF FUNDS TO MEET OPERATING DEFICITS. Require funding of any operating deficit projected on Form HUD-92264, including (where applicable to the program, e.g., Section 232 and 221(d) SRO projects) equipment and supply purchases from other than mortgage proceeds. Solicit data for establishing the operating deficit escrow from the Director, Housing Management Division. Mortgagor must supply funds as a firm commitment condition to meet project expenses during the HUD estimated period required to establish a sustaining level of operation. See the Mortgagee's Certificate, paragraph (10). Funding may be an:
- A. Agreement of Sponsors to Furnish Additional Funds, Form FHA-2476, accompanied by Bond Guaranteeing Sponsor's/mortgagor's Performance, Form FHA-2477. The bond must equal the sum required to be deposited in Form FHA-2476, or
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- (1-28)B. Additional Contribution by Sponsors/Mortgagors, Form HUD-92476A. The required amount may be: a cash escrow, United States bearer bonds with a market value equal to 115 percent of the required amount of the escrow, or an unconditional and irrevocable letter of credit.
1. Review the escrow agreement for sufficiency and the closing attorney must review it for legal acceptability.
 2. If excess mortgage proceeds are used for the cash escrow:
 - a. Do not accept a letter of credit for the operating deficit at initial endorsement.
 - b. Require mortgagee's statement acknowledging that it must receive HUD's written approval before making any disbursements from the escrow account.
- C. Waivers. Do not waive any of the above requirements for funding a projected operating deficit without written approval from the Headquarters Office of Insured Multifamily Housing Development.
- 1-29. SPONSOR'S GUARANTEE AGREEMENT. See Mortgagee's Certificate, paragraph (11). Require for Section 232 Board and care projects with independent living facilities a 12 month debt service reserve in addition to any required operating deficit escrow. See Handbook 4600.1 REV-1 for additional details on the debt service reserve.
- 1-30. DISCOUNTS, FINANCING FEES AND ISSUANCE COSTS. See Mortgagee's Certificate, paragraphs (18)(b) through (18)(f). Review the loan fees, including: discounts, permanent loan discounts, financing fees, bond issuance costs, and similar charges (fees) to be collected by/through the mortgagee and listed on the Mortgagee's Certificate, Form FHA-2434, and the required attachment explaining why each charge is needed to issue the obligations.
- A. Comparability. Do not approve fees that are excessive compared to current market interest rate levels.

- (1-30)B. Inform Mortgagee in writing of the aggregate amount that will be allowed at cost certification for discounts, financing fees and issuance costs, stated as a definite percentage of the mortgage. Reflect the percentage that will be recognized at cost certification in the margins of Form FHA-2434.
1. The amount must be the lesser of the prevailing rates or 3-1/2 percent of the mortgage, except
 2. Additional costs required for bond obligations may be recognized at cost certification, where the sponsor/mortgagor can't benefit monetarily from excess investment income or the proceeds from tax-exempt obligations.
- C. Require Mortgagee's Acknowledgement of the additional costs that HUD will allow at cost certification on a copy of HUD's letter to the mortgagee (identified in paragraph 1-30.B. above), and file it with the Mortgagee's Certificate for use in reviewing the cost certification.
- D. Dates Loan Fees Are Earned are as follows:
1. Construction loan fees are earned at initial closing, except for any portion that the loan documents provide for payment at a later date. Construction loan extension fees are not earned until the time such extensions are made.
 2. Permanent loan fees, and permanent loan extension fees are earned at final closing. A permanent loan in this instance is a loan separate and distinct from the construction loan, and for which the proceeds are used to pay off the construction loan.
 3. Unitary loan fees are earned at initial closing, except for any portion that the loan documents provide for payment at a later date.
 - a. A unitary loan is one where the loan and involvement of the investors spans both the construction and permanent phases of the loan, so that the construction and permanent loans represent one transaction.

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- (1-30) b. Where the loan documents approved by HUD

provide for a "discount," "permanent discount," "marketing fee," or "bond underwriting fee" (fee), whether in a lump sum, discounted advance, or other basis, and under the terms of its agreement with its investors or participants, or with its broker, the mortgagee is obligated to pay the fee at any time prior to the date of assignment of the mortgage, HUD will not surcharge the insurance claim by the amount of such fee.

1-31. FEE PAYMENT FROM CASH AVAILABLE TO MORTGAGOR. See Mortgagee's Certificate, paragraph (18).

- A. Fees Paid At Initial Closing. Excess mortgage proceeds may be used to pay construction and permanent loan discounts, including that for unitary loans, bond issuance costs, and GNMA indemnification escrow at initial closing to the extent recognized by HUD under paragraphs (18)(b) through (18)(e) of the Mortgagee's Certificate, where loan documents approved by HUD provide for the payment of such fees at initial closing.
- B. Fees Paid After Initial Closing, Excess mortgage proceeds may be used to fund permanent loan discounts, including that for unitary loans, and construction and permanent loan extension fees for payment after initial closing to the extent recognized by HUD under paragraphs (18)(b), (c), (d) and (f) of the Mortgagee's Certificate, where loan documents approved by HUD provide for the payment of such fees after initial closing, subject to the following:
 - 1. Require mortgagee to escrow sufficient funds in mortgagor's behalf to cover fees approved under the Mortgagee's Certificate, paragraphs (18)(b), (c), (d) and (f), for payment after initial closing,
 - 2. Require mortgagor to furnish a written agreement to HUD that any disbursements from the escrow accounts must require HUD's written approval,
 - 3. Do not accept a Letter of Credit at initial closing for any of the amounts to be satisfied from excess mortgage proceeds, and
 - 4. Such escrowed excess mortgage proceeds may be released when earned per paragraph 1-30.D.

1-32. DEFERRED FEE COLLECTION. Where the mortgagee, bond underwriter or issuer may exercise the option for deferred collection of discounts, financing fees, etc., permitted by paragraph 18(f), the deferred collection of these items must be an obligation of a third party.

A. Third Party Obliges, and the mortgagee, bond underwriter or issuer, must attest in writing that they will not look for payment from the: mortgagor, mortgaged property, mortgage proceeds, any reserve or deposit required by HUD in connection with the mortgage transaction, or rents or other income from the mortgaged property. Use Appendix 10, Specimen - Third Party Obligee Certification, for the purpose.

B. Promissory Note. The certifications in paragraph A. above may not be binding on any party except the mortgagee in certain instances, therefore, require two conformed copies of a promissory note at initial closing for which:

1. The maker must be the third party obligated for payment of the fee,
2. The form and content must be satisfactory to the maker and mortgagee,
3. The note may be unsecured or secured by pledging of specific assets, except that the assets must be completely separate from the mortgaged property or assets held in connection with it or its operation, including rental income and escrow accounts, and
4. The note must include the following statement on its face.

"It is a condition of this note that the payee or any subsequent holder hereof may not assert any claim arising from this note against the following assets of the maker:

The interest of the maker in property located at _____ and covered by a mortgage insured by HUD under Project No. _____ or deposit made with the mortgagee or another required by HUD in connection with the mortgage transaction or the rents or other income from the property."

- (1-32) 5. The mortgagor entity may issue to the third party obligated for future fees payment a residual receipts note or surplus cash note as evidence of the promissory note debt. In such event, use:
- a. Form FHA-1710, Residual Receipt Note, for non-profit mortgagors and cooperatives,
 - b. Form FHA-1712, Residual Receipt Note, for limited distributions mortgagors, and
 - c. Form FHA-2223, Promissory Note, for all other mortgagors.

1-33. BROKER'S FEES. See Mortgagee's Certificate, paragraph (20).

- A. Referral Fees are prohibited in every instance.
- B. Mortgagee May Not Pay Anything of Value directly or indirectly to any person or entity in connection with an insured transaction if the person or entity has received any other compensation from the mortgagor, seller, builder or any other person for services related to the transaction, or related to the purchase or sale of the mortgaged property, except as described in paragraph C. below.
- C. The Field Office Manager May Approve Compensation for services actually performed, where:
 1. The function must be performed in any event.
 2. The services are actually rendered and payment is reasonable and customary.
 3. The broker's fee is included on the Mortgagee's Certificate, or
 4. The mortgagor submits a separate letter to HUD identifying the fee paid, the name of the broker, the reasons why it was necessary to employ a broker, and certifying that there is no identity of interest between the mortgagor/sponsor and the broker, or between the mortgagee and the broker. The Field Office Manager must indicate approval of the fee in writing.

- 1-34. AGREEMENT AND CERTIFICATION, Forms HUD-3305, 3305A, 3306, or 3306A, obligates mortgagor to certify its actual costs of project construction or rehabilitation costs and to disclose any identity of interest among project participants.
- 1-35. COLLATERAL AGREEMENTS. Require mortgagor to submit before initial endorsement signed duplicate copies for any collateral agreements needed to cover unusual conditions affecting construction of the project including actions of the principals of the mortgagor entity.
- 1-36. MORTGAGOR'S CERTIFICATE obligates mortgagor to comply with various requirements, including civil rights, during the insured period.
- 1-37. MORTGAGOR'S ATTORNEY'S OPINION. At closing, the mortgagor's attorney must submit a comprehensive opinion, addressed to the Commissioner, as to the legality and adequacy of the contractual documents, and collateral agreements affecting the mortgagor entity or project. See Form FHA-1725.
- 1-38. INITIAL ENDORSEMENT OF CREDIT INSTRUMENT. The Field Office Manager is authorized to initially endorse the credit instrument (Mortgage/Deed of Trust Note) only after:
- A. The Closing Attorney's Certification that endorsement is in order, and
 - B. The First Year's MIP and Inspection Fee have been received.
- 1-39. REVISION OF THE INSURED MORTGAGE. After closing and initial endorsement of the credit instrument, the Field Office Manager must approve of any revision of the terms or conditions of the insured mortgage that results in any change in the:
- A. Principal Amount,
 - B. Interest Rate, or
 - C. Amortization provisions.

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- 1-40. LOCAL RENT RESTRICTIONS. Do not permit rent restrictions in the deed covenants or other closing documents, where a municipality wishes to implement affordability rent restrictions pursuant to a Comprehensive Housing

Affordability Strategy (CHAS) plan or other initiative, except where the municipality provides significant financial assistance, e.g., tax-exempt bonds, CDBG or land write down. Permitting higher than zoned siting densities alone does not meet substantial municipal financial assistance requirements. Where rent restrictions are approved:

- A. Require Mortgagor's Attorney's Opinion consistent with paragraph 1-41.B. for tax-exempt bond financing, except substitute the type of state/local financial assistance for "tax-exempt bonds" where applicable,
- B. Require Mortgagee's Attorney's Opinion consistent with paragraph 1-41.C. for tax-exempt bond financing, except substitute the type of state/local financial assistance for "tax-exempt bonds" where applicable, and
- C. Review Closing Documents in accordance with provisions for tax-exempt bond financing, paragraphs 1-41.D. and E.

1-41. TAX-EXEMPT BONDS. Projects financed with the proceeds from tax-exempt bonds pursuant to the Internal Revenue Code, Section 142(d), must meet minimum low income occupancy restrictions to exempt the earned interest income from Federal income taxation. Such projects typically contain special deed covenants and other recorded restrictions to assure owner compliance with its occupancy and use requirements.

- A. Low-Income occupancy Requirements. Require the owner to include with the initial closing review package the bond issuer's certification indicating which of the occupancy restrictions it will impose on the project, and review the closing documents for conformity.
 - 1. The bond issuer, not the project owner, must decide which of the two low income occupancy restrictions (2.a. or 2.b. below) will apply to a particular project not later than issuance of the bonds.
 - 2. Owners of residential rental projects must either meet the 20-50 test or the 40-60 test, i.e., set aside a minimum of either:

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- (1-41) a. Twenty percent of the units for occupancy by individuals whose income is 50 percent or less of the area median gross income (with

adjustments for family size) for the term of the qualified project period (20-50 test), or

b. Forty percent (25 percent in New York City) of the units for occupancy by individuals whose median gross income is 60 percent or less of the area median gross income (with adjustments for family size) for the term of the qualified project period (40-60 test).

3. "Qualified Project Period" means the period beginning on the 1st day on which 10 percent of the residential units in the project are occupied and ends on the latest of:

a. The date which is 15 years after the date on which 50 percent of the project units are occupied,

b. The 1st day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or

c. The date on which any assistance provided with respect to the project under Section 8 ends.

B. Mortgagor's Attorneys Opinion--Tax-Exempt Bond Financing must be on the attorney's letterhead and state:

"To: (Insert HUD),

I am the attorney for the mortgagor and have prepared or reviewed all of the documents on the organization of the mortgagor entity; the Note, Mortgage (deed of trust), Regulatory Agreement and other collateral documents submitted to you.

It is my opinion that:

(1-41)

1. The mortgagor is a valid existing legal entity; it has authority to engage in the business contemplated by this transaction; all incorporation fees and taxes have been paid; all pertinent security requirements have been met; the Note, Mortgage (deed of trust), Regulatory Agreement and other collateral

documents required by the lender to be signed by the mortgagor have been signed by the person(s) authorized to do so and are instruments legally binding on the mortgagor; and the mortgage (deed of trust) is a valid lien on the property described.

2. The building permit(s) has (have) been legally issued and construction (rehabilitation) in accordance with the plans and specifications is authorized by this (these) permit(s).

3. The proposed construction (rehabilitation) complies with all applicable zoning laws and requirements. There is no legal action pending and, to the best of my knowledge, there is no threatened legal action or proposed changes in zoning that would affect this transaction in any manner.

4. I certify that satisfactory arrangements have been made for payment of my fees for services and that I will assert no claim or lien because of such services against the mortgaged premises, mortgage proceeds or income from the premises.

5. Any contracts or other documents executed by the mortgagor or any other arrangements agreed to by the mortgagor in order to finance the mortgage with bonds exempt from taxation (and/or tax credits) under provisions of the Internal Revenue Code are consistent with the Mortgage, Mortgage Note, Regulatory Agreement, Building Loan Agreement, Construction Contract, and all other documents executed by the mortgagor and submitted to the lender in connection with the mortgage transaction."

(1-41)C. Mortgagee's Attorney's Opinion must also address the legal instruments as to the acceptability of any covenants. The HUD closing attorney must review the mortgagee's attorney's opinion and the applicable closing documents regarding tax-exempt bond (and tax credit) covenants. Tax-exempt bond required covenants are permitted on an insured project, only if:

1. The covenants are expressly subordinate to the HUD

insured mortgage, i.e., covenant instrument must contain a subordination clause;

2. The covenants will automatically terminate in the event of foreclosure or transfer of title by deed in lieu of foreclosure, i.e., covenant instrument must contain automatic termination clause;
3. Failure to comply with the covenants will not serve as a basis for default on the HUD-insured mortgage;
4. The covenants do not appear in the Note, Mortgage, HUD Regulatory Agreement, or any other HUD/FHA loan document;
5. The covenant instrument contains a provision stating that enforcement of the covenants will not result in any claim against the project, the mortgage proceeds, any reserve or deposit required by HUD in connection with the mortgage transaction, or the rents or other income from the property other than:
 - a. Available surplus cash, if the mortgagor is profit-motivated;
 - b. Available distributions and residual receipts authorized for release by HUD, if the mortgagor is limited distribution; or
 - c. Available residual receipts authorized by HUD, if the mortgagor is nonprofit.
6. The covenant instrument contains a provision making any subsequent amendment contingent on prior HUD approval;
7. Any provision requiring the owner to take any action necessary to preserve the tax exemption of the interest on the notes or bonds (and/or tax credits) (or prohibiting the owner from taking any

(1-41) action that might jeopardize the tax-exemption (and/or tax credit) is qualified to except actions prohibited (or required) by HUD pursuant to the National Housing Act, applicable mortgage insurance regulations, the HUD/FHA loan documents, or, if applicable, Section 8 of the U. S. Housing Act of 1937 and the regulations thereunder;

8. The covenant instrument does not contain any occupancy or use restriction that is more stringent or burdensome than the minimum requirements of the IRS's regulations, unless such restriction has been approved as meeting the requirements of paragraph 1-41.D.;
9. The covenant instrument does not conflict with any applicable HUD mortgage insurance or Section 8 regulations; and
10. The following paragraph (or a provision to the same effect) must be included in the covenant instrument:

"Notwithstanding anything in this document to the contrary, the provisions hereof are subordinate to all applicable HUD mortgage insurance (and Section 8, if applicable) regulations and related administrative requirements. In the event of any conflict between the provisions of this document and the provisions of any applicable HUD regulations, related HUD administrative requirements, or HUD/FHA loan documents, the HUD regulations, related administrative requirements or loan documents shall control."

- D. State/Local Occupancy, Use and/or Rent Restrictions on projects financed by proceeds from their tax-exempt obligations are often more restrictive than the minimum requirements of the Internal Revenue Code. The Field Office Manager may approve a State or local restriction exceeding the minimum requirements of the Internal Revenue Code, only if the following conditions are met:

1. There must be a valid statutory, regulatory or other legal basis for the imposition of the restriction. It should be clear that imposition of the restriction is necessary to enable the issuer to issue tax exempt bonds for the project.

- (1-41) 2. The Field Office must determine that the restriction is not likely to have an adverse impact on project occupancy, marketability or long-term feasibility. This determination must be made on a project-by-project basis. Solicit EMAD and Housing Management data.

3. The restriction must not conflict with any applicable HUD mortgage insurance regulations or related administrative requirements.
4. The restriction must not appear in the note, mortgage, HUD Regulatory Agreement or any other HUD/FHA loan document.
5. The restriction must be qualified to provide that it will automatically terminate in the event of foreclosure or transfer of title by deed in lieu of foreclosure. Such a termination provision must be included in every legal instrument (e.g., deed, land use restriction agreement, Regulatory Agreement, or financing agreement) in which the restriction appears.
6. Every legal instrument containing the restriction must include the following provisions:
 - a. "In consideration of HUD's agreeing to insure the mortgage loan, and in reliance by HUD upon the promises of the mortgagor, mortgagee and bond issuer to comply herewith, HUD has reserved the right to require the bond issuer to remove or void the restriction(s) describe each restriction that exceeds the requirements of the Internal Revenue code upon a determination by HUD that the restriction(s) is threatening the financial viability of the project (i.e., impairing the mortgagor's ability to sustain a level of income sufficient to meet all financial obligations of the project, including debt service costs, HUD-required escrows, and project operating expenses). In the absence of the issuer's compliance with a HUD request that it remove or void the restriction(s), such issuer expressly recognizes the power of HUD to take the appropriate action to unilaterally remove or void the restriction(s) and that HUD shall not have to look any further than the legal

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- (1-41) instrument containing the restriction(s) for the power to remove or void it."
- b. "Enforcement of the provisions of this instrument will not result in any claim against the project, the mortgage proceeds, any reserve

or deposit required by HUD in connection with the mortgage transaction, or the rents or other income from the property (other than available surplus cash)." For cases involving limited distribution mortgagors, substitute "available distributions and residual receipts authorized for release by HUD" for "available surplus cash."

- c. "Notwithstanding anything in this instrument to the contrary, the provisions hereof are subordinate to all applicable HUD mortgage insurance regulations and related administrative requirements. In the event of any conflict between the provisions of this document and the provisions of any applicable HUD regulations, related HUD administrative requirements, or HUD/FHA loan documents, the HUD regulations, related administrative requirements or loan documents shall control."

7. Rent restrictions must be in a form that permits the Field Office to make meaningful income estimates for the units subject to the restriction. For example:

- a. A restriction that limits the rent for a low or moderate income unit to a percentage of the actual tenant's income (an unknown amount at the time of HUD processing) is unacceptable.
- b. A rent limit based on a specified percentage of some recognized standard (e.g., 30 percent of 80 percent of the area median income or 120 percent of the Section 8 Existing FMR) may be acceptable.

E. Underwriting Review. Review the legal instruments, e.g., deed, land use restriction agreement, tax regulatory agreement, etc., containing tax exempt financing required covenants for any effect on the mortgage insurance underwriting.

1-42. LOW INCOME HOUSING TAX CREDITS. Tax credit provisions included in the Tax Reform Act of 1986, were designed to encourage owners to make rental housing units available to low income households at affordable rents. Where projects contain special deed covenants or other recorded provisions to assure owner compliance with occupancy and rent

restrictions for tax credit eligibility, comply with the following:

- A. Mortgagor's Attorney's Opinion--Tax Credits must be on the attorneys letterhead and state as provided in paragraph 1-41.B., except that where the term "tax exempt bonds" occurs, substitute the term "tax credits."
- B. Mortgagee's Attorney's Opinion must address the legal instruments as to the acceptability of any covenants. Covenants required for tax credits are permitted on an insured project only as permitted in paragraph 1-41.C. for tax exempt bonds.
- C. Underwriting Review must be conducted as provided in paragraph 1-41.E.
- D. Low Income Occupancy and Rent Requirements.
 - 1. For a minimum of 15 years the owner must assure occupancy that meets the same low income occupancy restrictions as in either paragraph 1-41 A.2.a or b, whichever the owner selects.
 - 2. Gross rents, inclusive of utility costs, for the project's low income units may not exceed 30 percent of the applicable qualifying low income limit, adjusted for family size.
 - 3. Secure Headquarters approval where project deed covenants or other restrictions for recordation subject more than 40 percent of the units to low income occupancy and rent restrictions, unless such project will receive project based Section 8 subsidy or comparable long-term State or local rental assistance for all of the low income units. In such instance proceed in accordance with paragraph 1-41.D.

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- 1-43. SUBSTANTIAL REHABILITATION PROJECTS. Require that a staff member visit the project within 1 week before initial closing to assure that it remains in the physical condition upon which underwriting determinations were made, i.e., that it has not suffered significant damage from storm, fire, vandalism, etc.
 - 1-44. PRECONSTRUCTION CONFERENCE. Consider conducting the preconstruction conference concurrently with the initial closing, since the required parties attend the closing, and

the preconstruction conference must be held before the start of construction. Instructions for conducting the preconstruction conference are in Handbook 4435.1 REV-1.

1-45. INITIAL DRAW may be made after recordation of the mortgage instruments. See Handbook 4435.1 REV-1 for information regarding an initial draw at initial closing.

1-46. MANAGEMENT INFORMATION SYSTEMS UPDATING.

A. Multifamily Insurance Processing System (MIPS).

1. Require the Chief, Mortgage Credit to reverify the information in the Closing Memorandum, Form FHA-290, prepared by the closing attorney, before giving it to the Automated Technology Associate (ATA) or other designated data input staff as the MIPS input data source.
2. Require the ATA or other designated Field Office staff to update the MIPS within 5 days of a project's initial closing.

B. Multifamily Insurance System (MFIS).

1. Complete the Official Receipt, Form HUD-27038, and Schedule of Project Collections, Form HUD-3416, in accordance with Handbook 4410.1, and
2. Mail within 5 days of a project's initial closing one copy each of the Closing Memorandum, Form FHA-290; Official Receipt, Form HUD-27038; and Schedule of Project Collections, Form HUD-3416; to:

U.S. Dept of HUD
Multifamily Insurance Operations Branch
P.O. Box 44124
Washington, D.C. 20026-4124