CHAPTER 15. BOND FINANCED PROJECTS

15-1. REVIEW OF FINANCING DOCUMENTS. The Field Office does not review financing documents associated with mortgage bonds.

A. The sponsor must submit, with the application for commitment processing, a separate statement itemizing the estimated costs of issuance, discounts and financing fees to be paid out of pocket by the sponsor/mortgagor and explaining the necessity of each cost.

B. Mortgage Credit:

1. Checks the statement for reasonableness, using the data from previously processed bond financed projects.

2. Make adjustment where appropriate.

3. Uses this information to develop the Total Estimated Cash Requirements Form HUD-92264-A, Supplement to Project Analysis.

15-2. LOAN RATES. The construction loan and permanent loan rates may exceed the interest rate on the obligations. When this occurs, the spread will create a surplus of funds which must be held by the trustee.

A. At initial closing, bond counsel must supply HUD with a legal opinion stating:

1. Any investment income received by the mortgagee but not held for its own account must flow to and be under the control of the bond trustee. The funds cannot flow through the books and records of the project.

2. The bond documents instruct the trustee to:

a. Invest the funds in an interest bearing vehicle which is federally insured.

b. Submit annual statements to the local HUD Field Office on these funds. The statements should accompany the project's annual audited financial statements.

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(15-2) c. The mortgagor may use the funds to;

(1) Cover costs associated with the financing transaction but not recognized in traditional HUD processing.

(a) Fund a debt service reserve account.

(b) Replace any letters of credit posted by the mortgagor for either the mortgage or the bond transaction, provided the cash escrow(s) remains under the control of the bond trustee.

(c) Cover negative investment income during the construction period or capitalized interest after final endorsement.

(d) Cost of issuance, as approved by HUD, beyond the 3.5 percent financing fees included in the project replacement cost.

(2) Pay the trustee's servicing fee on the obligations.

(3) Cure a mortgage default.

(4) Cover the prepayment penalty on the redemption of the bonds.

(5) Cover additional uses approved by HUD.

d. The funds are disbursed per HUD instruction.

e. Once the mortgage has been paid off, any funds remaining in the bond investment account may be released to the mortgagor.

B. In many cases, the interest rate on the bonds is unknown during the commitment process. Therefore, it is not uncommon for the mortgage interest rate to change once the bond interest rate is established. Due to time constraints, if the mortgage rate is lower HUD may not have sufficient time to reprocess the project. In such cases:

(15-2) 1. The firm commitment must contain the following condition:

"Any interest savings resulting purely from a differential between the HUD processed interest rate and the actual final interest rate may not be construed as excess funds that may be used to offset costs in other categories at the time of cost certification. Any such savings must be applied as a mortgage reduction."

2. An exception is that savings resulting from the early completion of construction may be used to offset cost certifiable overruns in other cost categories. Compute interest savings by:

(a) Recalculating the interest line item on Form HUD-92264, using the actual interest rate for the scheduled construction period.

(b) Subtracting the actual interest cost recognized at cost certification from the revised interest figure developed in (a) above.

C. Bonds may be sold at a premium to investors, i.e., investor pays an amount in excess of the face value of the bonds.

1. The premium results from the bonds' carrying a higher coupon rate than is generally available in the marketplace.

2. The premium paid on the bonds must be considered excess investment income.

3. The premium may be used to pay for additional costs associated with the issuance of the obligations.

15-3. ITEMIZED STATEMENT OF COSTS. Attached to and reflected in the Mortgagee's Certificate, Form HUD-2434, is an itemized statement of the costs of issuance of the obligations, discounts, and financing fees paid through the mortgagee.

A. The statement must explain why each individual item is necessary for the issuance of the obligations.

(15-3) B. Review the amount of each item to ensure its reasonableness in relation to comparable projects.

C. Prepare letter for the Director for Housing Development's signature informing the mortgagee that:

1. HUD will recognize for cost certification purposes the costs of issuance, discounts, and financing fees in an aggregate amount not to exceed the 3-1/2 percent included in the mortgage.

2. Exception may be made for additional charges if the sponsor/mortgagor could not benefit monetarily from excess investment income from the proceeds of the invested obligations.

D. The mortgagee, bond underwriter, and issuer have the option of deferring collection of additional discounts, financing fees, slow draw fees, etc., through the provision of paragraph 18(f) the Mortgagee's Certificate (HUD-92434).

1. The deferred collection of these items must be an obligation of a third party and both the third party and the mortgagee, bond underwriter or issuer must attest in writing that they will not look for payment from:

a. Mortgagor;

b. Mortgaged property;

c. Mortgage proceeds;

d. Any reserve or deposit required by the Commissioner and/or mortgagee in connection with the mortgage transaction; or

e. Rents or other income from the mortgaged property.

2. The mortgagor entity may issue, as evidence of the debt, a surplus cash or residual receipts note to the third party for costs identified in paragraph D above which HUD determines to be reasonable.

15-4. PRE-COST CERTIFICATION CONFERENCE INFORMATION. Explain at the pre-cost certification conference that:

A. If more than 3-1/2 percent in total financing fees is requested to be included in the mortgage calculation at cost certification, the mortgagor's accountant must detail in the notes to the financial statement:

1. Amount of interest paid on the obligations.

2. Source of the interest payments.

a. Construction loan proceeds.

b. Monies advanced from the developer.

c. Excess investment income.

3. Net amount of excess investment income.

4. Disposition of all escrowed funds, including any excess investment income, as specified in the trust indenture.

For example:

a. Payment of HUD-insurance project costs.

b. Payment of interest on the bonds.

c. Retirement of the bonds.

d. Reimbursement of any remaining investment income to either the issuer of the obligations or the mortgagor entity.

B. Do not recognize any costs paid by funds generated from the sale of bonds in excess of par.

C. Net excess investment income used to pay project costs will be treated as project income and used to reduce the total allowable costs after the calculation of BSPRA/SPRA.

D. Net effect of negative interest arbitrage (capitalized interest) may be recognized if there are offsetting savings in the mortgage, provided that the:

(15-4) 1. Arrangements for collecting capitalized interest were spelled out in the Mortgagee's Certificate, Form HUD-2434.

2. Developer could not benefit monetarily from possible excess investment income.

3. No money was expended from the surplus generated by the interest rate differential.

E. Any rebate to the sponsor/mortgagor from either the mortgagee, issuer, or bond underwriter automatically reduces the mortgage at cost certification. The following are two samples of the most common types of rebates.

1. Mortgagee/bond underwriter contributes a portion of the initial service charge that was collected to pay discounts or other fees.

2. Mortgagee/bond underwriter refunds a portion of the construction loan interest to the mortgagor or sponsor.

3. Refer to paragraph 11-12.A.