



MULTIFAMILY ACCELERATED PROCESSING (MAP) Guide

DRAFT for FEEDBACK
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<p>Chapter 3 - Programs</p> <p>3.1 General Program Requirements</p> <p>3.2 New Construction/Substantial Rehabilitation Program Requirements</p> <p>3.3 Section 221(d)4 Mortgage Insurance for Rental and Cooperative Housing – New Construction and Substantial Rehabilitation</p> <p>3.4 Section 220 Mortgage Insurance for Rental Housing for Urban Renewal and Concentrated Development Areas – New Construction and Substantial Rehabilitation</p> <p>3.5 Section 231 Mortgage Insurance for Rental Housing for Elderly Persons – New Construction and Substantial Rehabilitation</p> <p>3.6 Section 241(a) Mortgage Insurance for Supplemental Loans for Multifamily Projects</p> <p>3.7 Section 207/223(f) Mortgage Insurance for Purchase or Refinancing of Existing Multifamily Rental Housing</p> <p>3.8 Section 223(a)(7) Refinancing of Existing Insured Mortgages</p> <p>3.9 Property Insurance Requirements</p> <p>3.10 Large Loan Risk Mitigation Policies</p>	<ul style="list-style-type: none"> • Technical corrections and clarifications provided throughout the chapter, including clarification and re-emphasis on the prohibition against mandatory meal services in transactions for multifamily properties proposing new FHA mortgage insurance. • Implemented updated policy previously issued through Letters and Notices. • Language clarifying age-restricted housing: <ul style="list-style-type: none"> ➤ for Multifamily insured programs other than Section 231, FHA’s long standing policy is re-stated, 62+ Head-of-household, cannot discriminate against non-elderly family members. ➤ For projects with Low Income Housing Tax Credits and no Project-based rental assistance, the exemption for Housing for Older Persons (55+ for 80% of the units) may be considered. <p><i>[These sections are still under review and may be revised.]</i></p>

	<ul style="list-style-type: none"> • Guidance added for Section 241(a) for Supplemental Loans • The Section 223(f) eligibility threshold is re-affirmed as 3 years of operating history in order to support the valuation for Market Rate properties. Tax Credit and Project-based Section 8 properties will require 6 months stabilized occupancy. • Simplification of Large loan policy and minor changes to reflect recovery of real estate fundamentals and credit markets.
<p>Chapter 4 – Application Processing</p> <p>4.1 Introduction</p> <p>4.2 Stages of Application</p> <p>4.3 Lender Processing</p> <p>4.4 HUD Processing</p>	<ul style="list-style-type: none"> • Minor technical clarifications made throughout the chapter • Implementation of policy previously published through Letters and Notices • Introduction to the Single Underwriter Model under HUD Processing • Incorporates Standardized Narrative, electronic checklist formats and “Wheelbarrow” data sheet, all part of HUD’s ongoing progress moving toward electronic and streamlined processing improvements.
<p>Chapter 5 and 6 – Architectural and Construction Analysis</p> <p>5.1 Qualifications, Responsibilities, and Approval of Lender’s Representative</p> <p>5.2 Classification of Work and Eligible Construction Activities</p> <p>5.3 Required Architectural Services and Documentation by Construction Activity</p> <p>5.4 Architectural Standards and Other Criteria</p> <p>5.5 Construction Contracts</p> <p>5.6 Streamlined Processing Instructions for Sections 220, 221(d), 231 and 241(a) New Construction and Substantial Rehabilitation</p> <p>5.7 New Construction, Standard Processing – Concept Meeting through Firm Commitment</p> <p>5.8 Firm Commitment through Initial Endorsement – New Construction</p> <p>5.9 Substantial Rehabilitation, Standard Processing – Concept Meeting through Initial Endorsement</p> <p>5.10 Processing for refinance of Acquisition, Section 223(f) and 223(a)(7) and 241(a) for Repairs and Alterations</p> <p>5.11 Cost Estimating for Lenders</p> <p>5.12 Cost Package for Firm Commitment</p> <p>5.13 HUD Procedures</p>	<ul style="list-style-type: none"> • Changes implement previously published policy. • Changes that will be implemented by separate Housing Notice and Mortgagee Letter and the final version of this Guide to improve and standardize the physical assessment of properties, promote energy efficiency, and implement the CNA eTool for preparation of capital needs assessments and accessibility requirements. • Guidance given to role in HUD’s new Single Underwriter Model. • Guidance is provided to recognize energy efficiency in expense underwriting. • Clarification on guidance regarding remaining useful and economic life as it relates to amortization and future capital needs of the improvements. • Revised definition of substantial rehabilitation and the “two systems” rule. • The draft MAP Guide proposes an increase in the per unit repair limit to \$15,000 per unit (from \$6,500, established in and not updated since 1983) multiplied by the applicable high cost factor. To keep pace with inflation in the construction industry, this repair threshold will be indexed and increased annually by the same inflation factor used annually to adjust the overall per unit statutory limits, as published by the Consumer Finance Protection Bureau. • Implementation of policy relating to the definition and use of construction classes of work as defined in the International Building Code for Existing Structures (2012). • Policy guidance on ASHRAE Level 2 Energy Audits for all

	<p>properties greater than 10 years of age.</p> <ul style="list-style-type: none"> • Introduction of a 3-tiered classification of repairs for purposes of Fair Housing Accessibility Compliance and determining whether Architectural analysis and a General Contractor (and contracts) are required. • Use of AIA Form of Construction Contract for certain level of repairs under Section 223(f) is now permitted and/or required.
<p>Chapter 6 - Cost Processing - content has been included in Chapter 5</p>	<p>The following changes to previous Cost Chapter have been incorporated in Chapter 5:</p> <ul style="list-style-type: none"> • Addition of Sections 231 and 223(a)(7) under Lender’s Responsibilities and Deliverables • New requirement for Reserve for Replacement deposit calculations for waiver approvals • New section added detailing the streamlined processing deliverables. • CNA Limits for Substantial Rehabilitation projects has been added • Elimination of guidance for site not attributable (SNA) and cost not attributable to dwelling use from the calculation for maximum mortgage amount when Criterion 4 is not a factor in determining the maximum loan amount. • Definition provided for Furniture, Fixtures and Equipment (FF&E) • Policy clarification on inclusion of builder’s risk insurance with General Requirements and inclusion in residential CNA • Clarification is provided on the requirements for calculation of reserve-for-replacement deposits and PCNA requirements in 10 year increments. Independent Lender review of repair costs in PCNA is a required Firm stage deliverable
<p>Chapter 7 – Valuation Analysis & Market Study Requirements</p> <p>7.1 Introduction</p> <p>7.2 Selection of Appraisers and Market Analysts</p> <p>7.3 Third Party Appraiser and Market Analyst Qualifications</p> <p>7.4 Market Study Applicability and Requirements</p> <p>7.5 Content and Format of the Market Study</p> <p>7.6 Appraisal Requirements</p> <p>7.7 Estimating Project Income</p> <p>7.8 Operating Expense Estimates and Determination of Net Operating Income (NOI)</p> <p>7.9 Site Analysis</p> <p>7.10 Pre-Application Stage for Sections 220, 221(d) and 231</p> <p>7.11 Firm Commitment Processing for Sections 220, 221(d) and 231 (New Construction)</p> <p>7.12 Firm Commitment Processing for Section 223(f)</p> <p>7.13 Substantial Rehabilitation Processing for Sections 220, 221(d)</p>	<p>This chapter and Appendix have been revised to address existing guidance and Statutory authority, e.g.,</p> <ul style="list-style-type: none"> • Clarification regarding the relationship between HUD appraisers in the single underwriter model and USPAP appraiser guidelines. • HUD review appraiser participation in Hub and National Loan Committee, and Environmental reviews. • USPAP Standards 4 and 5 are removed. • Clarification regarding updated appraisals. <p>Additionally, a number of technical revisions and clarifications have been provided:</p> <ul style="list-style-type: none"> • “Ground Lease” section is substantially rewritten. The previous version has been unchanged since the mid-1960’s and pre-dated the Section 223(f) program. The new language

<p>and 231</p> <p>7.14 Calculating Operating Deficits</p> <p>7.15 Leaseholds/Ground Leases</p> <p>7.16 Tax Abatement Procedures</p> <p>7.17 Project Based Section 8 and LIHTC Processing</p> <p>7.18 Appraisal Review Policy and Requirements</p>	<p>clarifies policy around the valuation treatment of leasehold estates, provides for waivers only for public entity lessors, and re-states the requirement that any waivers of the standard form lease addendum must be approved by HUD HQs.</p> <ul style="list-style-type: none"> • Reference provided for National Registry of State Certified Appraisers. • Guidance regarding the lender’s responsibilities for reconciling significant differences between the appraisal and the market study. • Clarification on Market Study reporting requirements regarding unit features, net rents, tenant paid utilities and any rent subsidy. • Clarification on technical requirements of sub-market data for the type of housing proposed, defining the economic and demographic characteristics of the target market in terms of income levels, household size, and age range of prospective residents. • New sub-section added for valuation considerations unique to projects designed for elderly persons. • Implementation of policy on commercial space and income limitations. • Clarification of treatment of expenses under Criterion 3 and 5. • Clarified definition of responsibilities for determining remaining economic and loan term.
<p>Chapter 8 – Mortgage Credit Compliance, Underwriting Procedures and Processing Requirements</p> <p>8.1 Introduction</p> <p>8.2 Borrower Types – Single Asset Borrower Entity</p> <p>8.3 Who is a Principal</p> <p>8.4 Investigating Credit and Character</p> <p>8.5 Evaluating Financial Capacity – Analysis of Financial Statements</p> <p>8.6 Prior Approval of Controlling Principals/Borrowers With Insured Balances - \$250 Million or 25 or More Commercial Real Estate Assets</p> <p>8.7 Secondary Financing</p> <p>8.8 Required Application Processing Exhibits and Lender and HUD Responsibilities</p> <p>8.9 Term of Mortgage and Commencement of Amortization</p> <p>8.10 Sections 220, 221(d), 231, 241(a) Firm Commitment Processing – Determining Mortgage Amounts, Cash Requirements and Related Items</p> <p>8.11 Sections 223(a)(7) and 223(f) Firm Commitment Processing – Determining Mortgage Amounts, Cash Requirements and Related Items</p> <p>8.12 Firm Commitment Processing with Grants/Loans</p>	<ul style="list-style-type: none"> • The chapter has been reorganized to simplify content and reduce duplication. • Some previously published guidance and requirements have been included in the Appendices for chapter 8. • The definition and roles of a “principal” has been clarified, to address credit review of controlling, “passive”, and nonprofit principals, and ownership structures. • Technical clarification on financial requirements and investigation. • Prior Credit Approval for large portfolio borrowers is incorporated. • Implementation of updated guidance and technical clarification on secondary financing and tax credits.

<p>8.13 Insurance Upon Completion 8.14 Determining the Estimated Cash Requirements for Completing the Project 8.15 Bond Financed Projects</p>	
<p>Chapter 9 Environmental Review and Requirements 9.1 Introduction 9.2 Procedures 9.3 Contamination Analysis 9.4 HUD Staff Responsibilities in Reviewing Cases Requiring Remediation 9.5 Environmental Report</p>	<ul style="list-style-type: none"> • Changes to clarify existing guidance based on experience over the past 4 years. • Provides for Field Office Environmental Clearance Officers review and in projects in normally unacceptable or unacceptable noise zones, regardless of the size of the project. • The environmental professional firm conducting the Phase I must base its site analysis on the guidelines in the listed publications of the American Society of Testing materials (ASTM). • Guidance on field personnel responsibilities for remediation is also detailed. • Guidance has been updated surrounding the investigation, review, and deliverables required for environmental concerns such as Lead-based paint, Asbestos-containing materials, and Radon
<p>Chapter 10 Management Analysis 10.1 Introduction 10.2 Exhibits Required for Firm Commitment 10.3 Lender Review of Management Documents 10.4 Review of Previous Participation 10.5 Bonding Requirements for Agents 10.6 Management Agreement Requirements 10.7 Approval of Proposed Management Agent 10.8 Affirmative Fair Housing Marketing 10.9 Management Agent Responsibility for Escrow Administration</p>	<ul style="list-style-type: none"> • Filing electronic previous participation certification through the Active Partner Performance System (APPS). • New required exhibit for marketing, leasing and relocation plan. • Addresses coordination between HUD Production and Asset Management staff. • HUD Asset Management approval required to release operating deficit escrow.
<p>Chapter 11 Lender Underwriting, HUD Review and Closing Matters 11.1 General 11.2 Lender Underwriting 11.3 HUD Hub or Satellite Office Underwriting Review 11.4 Program Closing Provisions 11.5 Loan Fees 11.6 Title Matters 11.6 Mortgagor Entity's Organizational Documents 11.7 Mortgage or Deed of Trust Note</p>	<ul style="list-style-type: none"> • Technical clarifications have been added throughout the chapter. • Implementation of policy previously issued through Letters and Notices. • Updated discussion on HUD responsibilities for the Underwriting Review. • Deletion of section regarding closing forms and requirements due to inclusion in the Closing Guide.
<p>Chapter 12 Construction Period 12.1 Start of Construction 12.2 Pre-Construction Conference 12.3 HUD Construction Monitoring 12.4 Architect's Duties in Administering Construction Contract 12.5 Architect's Adequacy 12.6 Completion Inspections 12.7 Insurance of Advances and Related Matters 12.8 Construction Change Orders – General HUD Duties 12.9 Change Orders – Inspection Instructions</p>	<ul style="list-style-type: none"> • Technical clarifications made throughout the chapter. • Change in policy for review of request and calculation of increased mortgage amount. • Clarification given to escrow requirements for non-critical repairs. • Implementation of policy concerning escrow releases from Initial Operating Deficit account. • Implementation of risk mitigation policy to sustain the insured project by allowing the Borrower to apply any remaining construction contingency funds to change orders,

<p>12.10 Change Orders – HUD Architectural and Cost Instructions</p> <p>12.11 Change Orders – HUD Appraisal and Mortgage Credit Instructions</p> <p>12.12 Labor and Fair Housing and Equal Opportunity (FHEO)</p> <p>12.13 Surveys</p> <p>12.14 Permission to Occupy</p> <p>12.15 Escrowed Funds, Letters of Credit, Deposits, Holdbacks and Related Matters</p> <p>12.16 Insurance Upon Completion</p> <p>12.17 Completion of Repairs Pursuant to Section 223(f)</p>	<p>additional deposit to the Reserve for Replacement account, or to make a principal payment on the mortgage.</p> <ul style="list-style-type: none"> • Clarification on retainage policy as it relates to new construction and substantial rehabilitation. • Clarification on release of Working Capital escrow. • Updated policy in regards to treatment of land equity escrow. • Updated policy in regards to requirements for latent defects guarantee.
<p>Chapter 13 Cost Certification</p> <p>13.1 Projects that Must Certify</p> <p>13.2 Purpose of Certification</p> <p>13.3 Certifiable Costs</p> <p>13.4 Projects with LIHTCs are Exempt for Cost Certification Requirements</p> <p>13.5 Types of Cost Certification</p> <p>13.6 Entities that Must Cost Certify</p> <p>13.7 Cost Certification Sequence of Events</p> <p>13.8 Substantial Completion Date, Cut-off Date, and Final Completion Date</p> <p>13.9 Administrative Completion Date</p> <p>13.10 Submission Date</p> <p>13.11 Required Forms</p> <p>13.12 Required Statements and Certifications</p> <p>13.13 Deficiencies in Cost Certification Submission</p> <p>13.14 Mortgage Credit Limited Review</p> <p>13.15 Mortgage Credit Detailed Review</p> <p>13.16 Allowable Costs in Borrower’s Certification of Actual Cost</p> <p>13.17 Cost Review of Contractor’s Cost Certification</p> <p>13.18 Determination of the Nonprofit Borrower’s Initial Equity Investment</p> <p>13.19 Determine the Borrower’s Initial Investment</p> <p>13.20 Section 223(f) Modified Form of Cost Certification</p> <p>13.21 Special Instructions for Substantial Rehabilitation</p> <p>13.22 Mortgage Reduction after Cost Certification</p> <p>13.23 Increase in Mortgage Amount</p> <p>13.24 Restrictions on Mortgage Increases</p> <p>13.25 Processing a Mortgage Increase</p> <p>13.26 Authorization to Reopen Mortgage Transaction</p> <p>13.27 Deferment of Principal Payments</p> <p>13.28 Document Distribution</p> <p>13.29 Office of Inspector General</p> <p>13.30 Cost Certification Incontestability</p> <p>13.31 Post Closing Escrows</p>	<ul style="list-style-type: none"> • Clarification is provided concerning how to determine the Substantial Completion Date. • Several technical clarifications are made regarding the Cost Cut-Off Date. • Clarification on how to calculate the net operating income for replacement cost mortgage amount at the cost certification stage. • Implemented policy allowing the borrower the option to not set a cut-off date when the project is exempt from cost certification. • Clarification regarding construction and permanent lender fee and charges policy.

Chapter 14 Low Income Housing Tax Credit (LIHTC) and Other Tax Credit Program Guidance

- 14.1 Introduction
- 14.2 Affordable Housing Underwriting and Program Guidance in Other Parts of the MAP Guide
- 14.3 Historic and New Markets Tax Credits
- 14.4 Subsidy Layering Review
- 14.5 Evidence of Tax Credit or Private Activity Bond Cap Allocations
- 14.6 Single Underwriter and Technical Reviews
- 14.7 Treatment of HAP Contract Renewals for Section 8 Assisted Tax Credit Projects
- 14.8 Application/Submission Requirements
- 14.9 Architecture and Engineering
- 14.10 Mortgage Credit Review for Tax Credit Projects
- 14.11 Identities of Interest in Tax Credit Transactions
- 14.12 Calculation of Mortgage Amounts for Tax Credit Projects
- 14.13 Developer Fees and GC Profit
- 14.14 Structuring of Secondary Debt in Tax Credit Transactions
- 14.15 Tax Credit Equity Pay-In Schedule
- 14.16 Bridge Loans in Tax Credit Projects
- 14.17 Syndicator and Investor Fees from Operations
- 14.18 Vacancy Rates
- 14.19 Other Matters
- 14.20 FHA Tax Credit Pilot Program Expansion

- Significant changes to this chapter focusing on implementation of policy, previously issued as well as new policy.
- Treatment of deferred developer fees as a mortgageable cost, as well as how these fees can be structured as secondary debt under certain conditions.
- New section has been added to describe the single underwriter model for tax credit program applications.
- Clarification regarding approval documents to be used in tax credit projects.
- Clarification regarding certain 2530 exclusions for nonprofits.
- Implementation of policy regarding passive partners' use of the *Rider to Security Agreement for LIHTC Properties* that allows for pre-approval of a special limited partner.
- Implementation of policy regarding passive partners' new *Identification and Certification of Eligible Limited Liability Investor Entities* that has replaced the previous version LLCI form.
- Clarification surrounding treatment of identity-of-interest relationships in Tax Credit transactions, including disclosure statements.
- Fees may be limited when identity-of-interest relationship exists between developer and general contractor.
- Implementation and clarification on policy relating to structuring of secondary debt in Tax Credit projects including 1) limitation on required payments from surplus cash only, 2) limitation on required secondary debt payments to 75% of surplus cash, 3) use of a promissory note, and, 4) automatic re-subordination in a refinancing.
- Total amount of secured secondary debt is limited to the amount of total development costs as defined in a comprehensive Sources and Uses statement.
- Clarification given on policy regarding minimum fixed percentage of LIHTC equity pay-in, and acceptable terms of temporary Bridge loans used to fund such equity, i.e., 1) they cannot be secured with the property, 2) the term cannot extend beyond one year after delivery of the investor's 8609 form, and 3) the Bridge Loan borrower cannot be the single asset mortgagor.
- Certain lenders approved to have Syndicator identity-of-interest relationships with greater than 25% equity interest – limit increased from 5 to 10 Firm Commitment submissions per year.
- Significant changes in treatment of developer fees for LIHTC projects:
 - treated as mortgageable costs,
 - Developer Fees cannot be taken in addition to BSPRA or SRPA,
 - Guidance provided as to when deferred developer

	<p>fees may be structured as secondary debt, and whether/when such deferred fees can be paid off in a subsequent transaction.</p> <ul style="list-style-type: none"> • Eliminated LTV limit on secured secondary debt, including seller financing, for Tax Credit projects. • Clarification given as to treatment of syndicator and investor fees vis a vis cash flow split for M2M and other tax credit projects. • Implementation of updated policy regarding separate vacancy rates for underwriting of tax credit projects distinguished by project type. • Guidance given regarding tax exempt bond financing structure allowed for 4% tax credit projects with FHA financing. • New Lender Certification form model document is available.
<p>Chapter 15 Quality Assurance Enforcement Actions</p> <p>15.1 Oversight of MAP Lender 15.2 Authority to Issue MAP Sanctions 15.3 Basis for Issuing a Warning Letter of Sanctioning a MAP Lender 15.4 Administrative Record 15.5 Warning Letters 15.6 MAP Probation 15.7 MAP Suspension 15.8 MAP Termination 15.9 Settlement Agreements 15.10 MAP Lender Review Board 15.11 Support Staff for MAP Lender Review Board 15.12 Procedures for Sanctions 15.13 Notice of Violation 15.14 Notice of Action 15.15 Appeals 15.16 Limited Denial of Participation 15.17 Referral to the Mortgagee Board or the Inspector General 15.18 Other Enforcement Actions</p>	<ul style="list-style-type: none"> • All references to the Lender Quality Monitor Division (“LQMD”) is replaced with the division’s new title, the Asset Management Counterparty Oversight Division (“AMCOD”). • Technical clarifications made concerning various enforcement action protocols.
<p>Chapter 16 Master Lease Structuring to Facilitate the use of Tax Credits</p>	<ul style="list-style-type: none"> • Most of this chapter has been deleted as the Master Lease structure is used only infrequently. The structuring of “master” leases in multifamily insured transactions will be reviewed on a case by case basis until such time as additional policy guidance is issued (scheduled prior to issuance of the final 2015 MAP Guide.) • A related Appendix to this chapter contains a chart describing a “Sandwich” lease structure that has been used for Historic or New Market Tax Credit structures.
<p>Chapter 17 Refinancing Cooperative Housing Projects under Section 207 pursuant to Section 223(f)</p> <p>17.1 Introduction 17.2 Background 17.3 Program Requirements</p>	<ul style="list-style-type: none"> • This chapter provides for some technical corrections and clarifications to assist in the underwriting and processing requirements • Elimination of the requirement for a regulatory waiver to accept an application with a Cooperative borrower

<p>17.4 Program Requirements – Technical Processing 17.5 Program Requirements – Issuance of Firm Commitment and Loan Closing</p>	<p>structure.</p>
<p>Chapter 18 Section 223(a)(7) 18.1 Purpose of Section 223(a)(7) 18.2 Consolidation of Applicable Guidance 18.3 Basic Program Requirements 18.4 Processing</p>	<ul style="list-style-type: none"> • New chapter of the MAP Guide, including policy and processing requirements for the refinancing of FHA-insured multifamily projects under Section 223(a)(7). • The chapter addresses MAP requirements applicable to Section 223(a)(7) loans and consolidates previous guidance from Mortgagee Letters and handbooks dating back to the early 1990s. • Section 223(a)(7) loans requires different application exhibits and processing timelines than other insurance programs

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Chapter 1 Introduction

1.1 MAP and the Guide

Multifamily Accelerated Processing (MAP) is designed to establish national standards for approved lenders to prepare, process and submit loan applications for Federal Housing Administration (FHA) multifamily mortgage insurance. The MAP Guide provides - in one volume with appendices – guidance for HUD staff, lenders, third party consultants, borrowers, and other industry partners. Topics include mortgage insurance program descriptions, borrower and lender eligibility requirements, application requirements, underwriting standards for all technical disciplines and construction loan administration requirements. The MAP Guide only applies to FHA multifamily mortgage insurance programs. Except to the extent lender monitoring or enforcement activities overlap, Section 232 and other programs administered by the Office of Healthcare Programs are not addressed by the MAP Guide.

The Guide has been updated to reflect various organizational, policy and processing changes implemented since the last edition was published in 2011. Examples include electronic submission of data in a standardized format, the consolidation of HUD Field Offices, workload sharing, and a “risk-based” underwriting approach. The Multifamily Transformation is consolidating the Multifamily Hubs and Program Centers into Regional Centers and Satellite Offices. The terms Regional Center and Satellite Office are meant to include Multifamily Hubs and Program Centers for those parts of the country that have not yet been consolidated.

Statutory authority for the implementation of MAP is contained in the basic insuring authority for each of the programs covered in MAP, pursuant to the National Housing Act, Sections 220, 221(d)(4), 231, 241(a), 223(a)(7), and 223(f). Additionally, Section 211 of the National Housing Act authorizes the Secretary to make such rules and regulations as may be necessary to carry out the provisions of the Act. The FHA requirements listed in HUD regulations covering each MAP eligible program are fully described in this MAP Guide.

1.2 Purposes of MAP

The MAP program is intended to provide a consistent, expedited mortgage insurance application process at each HUD Multifamily Regional Center or Satellite Office. HUD no longer accepts new applications for the covered programs, either for Pre-application review or for Firm Commitment review, under local “fast-track” processing. All MAP eligible projects must be submitted using MAP processing unless a waiver is granted to process under Traditional Application Processing (TAP). Such waiver authority is retained by HUD Headquarters’ Director of Multifamily Production.

Applications for TAP processing require more work and responsibility by HUD staff, and accordingly a higher application fee may be charged. Projects not eligible for MAP, and which may be submitted under TAP are:

- Applications submitted by FHA approved multifamily lenders who are not approved to submit MAP applications,
- Applications where there is an identity of interest between the lender and the borrower or affiliates of either, or
- Applications for mortgage insurance under Programs or Sections of the Act not covered by MAP (e.g. Cooperatives under Section 213).

Some MAP approved Lenders (MAP Lenders) only originate loans and do not close or service them. After obtaining a Firm Commitment for mortgage insurance under MAP, the originating lender may sell or transfer the Firm Commitment to another MAP Lender. The second MAP Lender will close the loan, oversee the construction loan administration, if applicable, and service the loan in accordance with HUD requirements. At the Pre-application submission, the originating lender should inform the Regional Center or Satellite Office if it does not intend to service the loan or administer the construction loan, and identify which lender will be responsible for those functions. The second lender must identify their construction loan administrator before or at initial endorsement. A loan servicer who receives a transferred MAP loan for servicing must be FHA approved for multifamily housing and have an approved Construction Loan Administrator, unless the loan is a refinancing with no repair escrow. The servicing lender generally is, but is not required to be, a MAP approved Lender.

MAP is intended to:

- A. Increase HUD’s reliance upon the lender’s due diligence, and increase the MAP Lender’s accountability for its due diligence and underwriting.
- B. Establish a process that significantly reduces the amount of HUD review time.

- 1 C. Strike a careful balance between expedited processing and ensuring an acceptable level of
2 risk management for HUD's multifamily mortgage insurance programs.
- 3 D. Have in one volume, the MAP Guide, the basic information required for loan origination
4 by the lender and for review by HUD staff.
- 5 E. Bring Handbook and Notice instructions current and maintain up-to-date instructions
6 through amendments to the MAP Guide.
- 7 F. Provide the lender with predictable and consistent underwriting guidelines, thus
8 facilitating efficient processing and better service for borrowers.

9 **1.3 Brief Summary of MAP**

10 A. Lender Qualifications and Monitoring

11 By permitting a MAP lender to prepare much of the documentation for an application for
12 mortgage insurance, HUD places confidence in the lender's integrity and competence. A
13 lender wishing to submit a MAP application must be:

- 14 1. An FHA approved lender. See the Mortgagee Approval Handbook (4060.1).
- 15 2. Approved by the Asset Management and Counterparty Oversight Division (AMCOD,
16 formerly Lender Qualification and Monitoring Division or LQMD) at HUD
17 Headquarters. See Chapter 2 of the MAP Guide.
- 18 3. Subject to Quality Assurance Enforcement Actions. See Chapter 15 of the MAP
19 Guide.

20 B. Programs Covered by MAP

21 MAP may be used for the following programs, identified by section of the National
22 Housing Act:

- 23 • 220 - new construction or substantial rehabilitation of mixed use projects in urban
24 renewal areas;
- 25 • 221(d)(4) - new construction or substantial rehabilitation of apartments,
- 26 • 223(a)(7) - refinancing of FHA insured mortgages;
- 27 • 223(f) - refinancing or purchase of existing apartments;
- 28 • 231 – new construction or substantial rehabilitation of housing for the elderly; and
- 29 • 241(a) Supplemental Loan program for rehabilitation or additions to projects
30 which have an FHA insured first mortgage.

1 C. Application processing instructions are described in Chapter 4. Standard Processing
2 Times are detailed in Appendix 1 to this Guide. All periods longer than two weeks are
3 described in calendar days, and periods of two weeks or less, in business days.

4 HUD has certain responsibilities which it does not assign to the lender, including
5 responsibility for the environmental clearance on Form HUD-4128 (even though the lender
6 prepares information for HUD's review), approval of the borrower's Affirmative Fair
7 Housing Marketing program, and issuing the commitment for mortgage insurance.

8 D. Construction Responsibilities

9 1. Under MAP, HUD must approve the initial and final draws.

10 2. HUD will contract, or perform or otherwise provide, for inspection duties and will
11 provide copies of the Trip Report to the MAP lender. Generally, HUD will rely on
12 one inspection per month, however the Multifamily Regional Director has discretion
13 to require additional inspections based on fact specific circumstances.

14 3. The MAP lender will prepare and approve the interim draws during construction.

15 4. HUD must approve the construction amount for each item in the initial and final
16 advance, and for each Change Order during construction.

17 E. Servicing

18 MAP makes no changes in procedures for servicing or asset management, except for
19 servicing lenders with prior approval for delegated responsibility for repair escrow
20 administration. See Section 1.2 above for guidance on MAP approved lenders who only
21 originate loans and transfers the loan(s) to another FHA approved lender for servicing.

22
23 **1.4 Relation of MAP to Handbooks, Notices and**
24 **Regulations**

25 A. All applicable HUD Handbooks, Notices and Forms remain in effect and will be used for
26 traditional HUD processing of mortgage loan applications. For applications under MAP,
27 the Guide incorporates the majority of Handbook, Notice and Mortgagee Letter
28 requirements and includes in the Appendix the forms that are required for most
29 applications. If there is a conflict between the Guide and the Handbooks or instructions
30 for various HUD forms, the Guide will take precedence. Lenders with questions should
31 address them to the Regional Center or Satellite Office processing the application.
32 Where the Guide is silent on a matter, the lender should consult the following MAP
33 website: <http://www.hud.gov/offices/hsg/mfh/map/maphome.cfm>, or the Regional
34 Center or Satellite Office processing a particular application.

- 1 B. Consistent with their level of approval, the lender must be familiar with the basic
2 programmatic requirements and regulations of the insurance programs set forth in 24 Code of
3 Federal Regulations, including but not limited to Part 200.
- 4 C. The lender is encouraged to contact a Regional Center or Satellite Office if any issues are
5 not addressed in the Guide or if any clarifications are needed. *See* Chapter 11 on
6 Underwriting for waiver procedures. The Multifamily Regional Director may waive non-
7 regulatory or non-statutory provisions of the Guide, although Chapter 11 specifies a
8 number of requirements that may not be waived without prior approval of HUD
9 Headquarters (HQ). Regulatory provisions may be waived only on approval of the
10 Assistant Secretary for Housing - FHA Commissioner. Statutory provisions may not be
11 waived.
- 12 D. Any waiver of this Guide granted by the Multifamily Regional Director must be
13 documented in the Regional Center or Satellite Office docket, along with the lender's
14 request and supporting documentation for the approval. The Form HUD-2 must be
15 submitted electronically to the HUD HQ Office of Multifamily Housing Production's
16 SharePoint site in accordance with outstanding instructions. No hard copies need to be
17 submitted to HQ. HQ will periodically review waivers to determine if changes to the
18 Guide or to the regulations are appropriate.
- 19 E. Program Obligations. HUD made technical and substantive changes when it adopted
20 new and updated FHA multifamily loan closing documents. The term "directives" was
21 eliminated and substituted with the term "Program Obligations." "Program Obligations"
22 refer to:
- 23 1. All applicable statutes and any regulations issued by the Secretary that apply to the
24 Project, including all amendments to such statutes and regulations, as they become
25 effective, except that changes subject to notice and comment rulemaking shall
26 become effective only upon completion of the rulemaking process, and
 - 27 2. All current requirements in HUD handbooks and guides, notices, and mortgagee
28 letters that apply to the Project, and all future updates, changes and amendments
29 thereto, as they become effective, except that changes subject to notice and comment
30 rulemaking shall become effective only upon completion of the rulemaking process,
31 and provided that such future updates, changes and amendments shall be applicable to
32 the Project only to the extent that they interpret, clarify and implement terms in the
33 applicable closing document rather than add or delete provisions from such
34 document. Handbooks, guides, notices, and mortgagee letters are available on
35 HUD's official website: (<http://www.hud.gov/offices/adm/hudclips/index.cfm>).

36

37

1.5 Workload Management

A. Applications for mortgage insurance should be submitted to the Regional Center or Satellite Office having jurisdiction for the area where the property is located (the “originating” office). The Regional Center or Satellite Office Director is responsible for workload management within their Regional Center or Satellite Office, including:

1. Delegation and staff assignments,
2. Participate in Workload Sharing,
3. Priority of application processing,
4. Meeting standard processing times, and
5. Loan Committee.

B. Workload Sharing. Depending on staff capacity and programmatic expertise, HUD may transfer processing assignments to other Multifamily Regional Centers or Satellite Offices (“processing” offices) through Workload Sharing. The originating Multifamily Regional Director will retain Commitment Authority but, closing responsibility will be assumed by the processing office, following protocols of the originating office and counsel. Responsibilities assigned by the Guide to a Regional Center or Satellite Office Director may be delegated unless specifically restricted by the Guide, statute or regulation or by existing published delegations of authority.

C. Washington Docket. At the “initial”/“final” endorsement and closing, the Regional Center’s Closing Coordinator or other appropriate designated staff should assemble a set of original documents (or as HUD allows, copies) for the Washington Docket, in accordance with the requirements and procedures set forth in the MAP Guide Appendix 11E. If originals of recorded documents are unavailable because of filing or recording procedures, a completely legible copy should be collected (certified true and correct by the recorder or by the title company). Note that the Phase I Environmental Clearance is a program requirement and a supporting document for form HUD-4128, *Environmental Assessment and Compliance Findings for the Related Laws*. It should remain with the HUD-4128 in the Washington Docket as a part of the permanent, historical file.

D. Initial Endorsement Diligence Review. The Regional Center or Satellite Office Director and program staff will review the lender’s request for initial endorsement and closing, and supporting materials in accordance with Program Obligations. In this review, the Multifamily Regional Director and program staff should confirm the information listed on the Initial Endorsement Diligence Review Worksheets, attached in the MAP Guide Appendices 11A – 11D, and may use such worksheets to document compliance with Program Obligations. Applications participating in Workload Sharing will have closing

- 1 requirements performed by the processing office, following protocols of the originating
- 2 office and counsel.
- 3

DRAFT

Chapter 2 Lender and Underwriter Qualifications

2.1 Introduction

- A. MAP requires lenders and underwriters to be skilled in underwriting multifamily housing loans and in preparing applications for FHA multifamily mortgage insurance. MAP Lenders and their Underwriters must be approved by the Asset Management and Counterparty Oversight Division (“AMCOD”).
- B. Approval of a MAP Lender or underwriter by the Asset Management and Counterparty Oversight Division is on a nationwide basis, so that the MAP Lender and their Underwriter may process MAP loans regardless of which Regional or Satellite Office will be processing the loan. By accepting the opportunity to use MAP, a MAP Lender and Underwriter agrees that its MAP loans will be subject to post-endorsement review by the Asset Management and Counterparty Oversight Division and that if it fails to meet HUD standards for underwriting loans, its MAP designation may be terminated. MAP approval does not expire but may be terminated in accordance with the Quality Assurance Enforcement Actions in Chapter 15.
- C. Approval by the Asset Management and Counterparty Oversight Division as a MAP Lender is a prerequisite to participation in the MAP program, but MAP approval does not obviate the need to have an experienced team on each application. If the HUD office has concerns regarding the MAP Lender’s or its Underwriter’s performance or capabilities, the office should consult with the Asset Management and Counterparty Oversight Division for additional monitoring or potential enforcement action.

The MAP Lender is responsible for insuring that all third party contractors meet the requirements outlined in the MAP Guide, including the USPAP Competency provision and jurisdictional certification requirements. If the HUD office has concerns regarding the third party contractor’s past performance or capabilities, the office should consult with the Asset Management and Counterparty Oversight Division for potential enforcement action.

- 1 D. The originating MAP Lender may sell or transfer a MAP application only upon receipt of
2 a Firm Commitment. The application may only be sold to another MAP approved lender
3 not currently subject to any suspension or Limited Denial of Participation penalties, and
4 within the limitations on MAP Lenders with identities of interest with the Borrowers (or
5 affiliates of both).

6 2.2 Lender Qualifications

- 7 A. Lender MAP approval requests should be sent to:
8 Asset Management and Counterparty Oversight Division
9 Office of Multifamily Development
10 Room 6151
11 451 7th Street, SW
12 Washington, DC 20410
13 FAX Number: 202-401-9087
- 14 B. The lender prepares the application for approval as a MAP Lender. There is no specific
15 required form for this application. Upon receipt of all the information specified in
16 Section 2.7, the Asset Management and Counterparty Oversight Division will process the
17 application within 30 days.
- 18 C. The Director of the Asset Management and Counterparty Oversight Division must
19 approve each MAP Lender in writing. The names of approved MAP Lenders will be
20 posted on the HUD website at:
21 <http://www.hud.gov/utilities/intercept.cfm?/offices/hsg/mfh/map/aprvlend.pdf>, and for
22 the HUD staff at: <http://hudatwork.hud.gov/po/h/hm/fog/dev/authsign.pdf>.
- 23 D. The Asset Management and Counterparty Oversight Division may disapprove an
24 application on the grounds that: a) it fails to meet the standards set forth in Section 2.3,
25 b) it fails to provide sufficient information required by Section 2.7 or, c) there are
26 specified deficiencies that must be corrected. An appeal of the Asset Management and
27 Counterparty Oversight Division's decision to disapprove an application, or specific
28 conditions of approval, may be made to the Deputy Assistant Secretary for Multifamily
29 Housing.
- 30 E. If the MAP Lender's approval has been terminated, the Lender may not reapply for 12
31 months after termination. (See Chapter 15, Section 15.8.E) The lender may appeal its
32 termination as provided in Chapter 15, Section 15.15.

- 1 F. The applicant should submit one complete hard copy and an electronic version of the
2 application.

3 **2.3 Standards Required for Qualification**

4
5 A MAP Lender must demonstrate that it is an FHA approved multifamily mortgagee
6 pursuant to 24 CFR Part 202, that it is financially sound, that it has on staff principal
7 employees with the necessary multifamily underwriting experience required by this Guide,
8 and that its record with FHA-insured or conventional multifamily loans has been satisfactory.
9 An FHA Lender will not be granted MAP approval relying on a multifamily underwriter
10 engaged on a contract basis for a particular loan application. The requirements are discussed
11 in this Section and the required application exhibits are listed in Section 2.7, Application
12 Package.

13 A. A Lender must submit a copy of the approval letter they received that states they are an
14 FHA-approved multifamily mortgagee as a result of submitting Form HUD-92001-B,
15 Branch Office Notification Title I/ Title II.

16 B. The Lender must not be subject to judgments, administrative claims, or lawsuits, which
17 would seriously affect its ability to do business and must not unlawfully discriminate.
18 Section 2.7 requires the lender to report any lawsuits or judgments filed or pending
19 against it within the past three years including any for discrimination in employment or in
20 lending practices.

21 C. Multifamily underwriting experience on staff is a key to MAP approval. The Lender
22 must identify staff persons with the level of training and experience required pursuant to
23 Section 2.11 below. The Underwriter must have worked regularly in the multifamily
24 lending business and have underwritten the required number of transactions pursuant to
25 Section 2.11 below, which have been funded. The Underwriter must attend a MAP
26 training session conducted by HUD before submitting an application or Pre-application.
27 HUD will defer this requirement for otherwise qualified underwriters until such training
28 is offered. MAP training will be held periodically by HUD. Training announcements will
29 be posted on the MAP home page website under MAP Underwriting training at
30 <http://www.hud.gov/offices/hsg/mfh/map/maptraining.cfm>.

31 D. The lender's application must identify experienced staff who have the authority to
32 underwrite loan applications and sign the narrative summary in a loan application. The
33 applicant must also describe the ownership of the Lender and identify whose signatures
34 may bind the Lender for its responsibilities under MAP.

- 1 E. FHA multifamily experience is not specifically required for initial approval as a MAP
2 Lender, but if the Lender lacks FHA experience, additional emphasis will be place on
3 consistent and recent analogous conventional multifamily lending experience. For any
4 loan processed under MAP, the lender must thoroughly understand FHA requirements for
5 its mortgage insurance programs.
- 6 F. A lender may be rejected for MAP qualification for a recent history of assignments of
7 FHA-insured loans. The reason for any assignments will be subject to the evaluation of
8 the Asset Management and Counterparty Oversight Division. There may be a variety of
9 reasons for assignments, such as unpredictable economic changes in the area, inadequate
10 servicing or poor quality underwriting. Asset Management and Counterparty Oversight
11 Division will review any loan which the applicant has underwritten and endorsed within
12 the previous five years and which has defaulted and been assigned to HUD. The purpose
13 of the review will be to determine whether the Lender was at fault in its origination of a
14 loan that did not perform satisfactorily, or if there was a pattern of poor performance.
- 15 G. The Lender will submit a list of the Regional and Satellite Offices (or Hubs and Program
16 Centers) with which it has worked in the previous two years. The Asset Management and
17 Counterparty Oversight Division will contact those offices to ascertain their experience
18 with the applicant and the responses will be included in the Lender's file. A pattern of
19 unsatisfactory applications at one or more Hubs or Program Centers may be grounds for
20 rejection of the Lender.

2.4 Loan Consultants/Loan Brokerage

23
24 It is common practice for Lenders to use consultants, individuals and companies, to increase
25 origination and underwriting capacity. The term consultant, as used here, applies to a
26 mortgage broker, loan correspondent and packager who is not a MAP approved Lender. A
27 consultant may have the following roles in FHA multifamily programs:

- 28 1. Under TAP, the consultant may refer new business to a Lender including information
29 supplied by a proposed borrower/sponsor.
- 30 a. The consultant may provide a wide range of additional services to the Lender. HUD
31 offices may accept application packages, correspond with and rely on information
32 submitted by the consultant on behalf of the Lender.
- 33 b. The consultant's fee is paid solely from either the mortgagee's fees, or the borrower
34 or sponsor or affiliated entities, but not both.

- 1 c. The consultant cannot have any identity of interest with the borrower, sponsor or
2 affiliated entity. HUD may permit an exception to the rule if:
- 3 (1) The consultant's regular business is brokering and processing loans; and
- 4 (2) The relationship is fully disclosed to and approved by HUD before an
5 application for mortgage insurance is submitted.
- 6 2. Under MAP, the consultant's sole role is to refer new business to a MAP Lender
7 including information supplied by a proposed borrower/sponsor.
- 8 a. The consultant's fee must be paid solely from the Lender's fees, and must be
9 disclosed in the MAP Lender's underwriting narrative.
- 10 b. The consultant cannot have any identity of interest with the Borrower/sponsor or any
11 affiliated entity.
- 12 c. There is no additional role for the consultant. HUD only accepts application
13 packages from, corresponds with, and relies on information submitted by an
14 approved MAP Lender. HUD will only deal with employees of the MAP Lender and
15 only accept documents signed by authorized signatories of the MAP Lender. MAP
16 Lenders are expected and authorized to hire third party contractors for appraisal,
17 architecture and cost, market analysis, environmental assessments, and specialized
18 reports related to any of these technical disciplines. The MAP Underwriter performs
19 the mortgage credit and real estate underwriting function and must be a full time
20 employee. The third party contractors cannot have any identity of interest with the
21 Borrower/sponsor or any affiliated entity. The MAP Lender is responsible for the
22 conclusions and recommendations of the third party reports, except as modified,
23 explained, and justified in their underwriting.

24 **2.5 MAP Lender Underwriting and Construction** 25 **Loan Administration Requirements** 26

27 A. Major Duties and Responsibilities of the Underwriter

28 The Lender's underwriter is responsible for mortgage credit analysis. The Underwriter or
29 the Construction Loan Administrator is responsible for management of the Lender's
30 responsibilities during the construction period.

1 Duties and responsibilities associated with the application underwriting are as follows:

- 2 1. Make a determination of the acceptability of the general contractor, supervisory
3 architect, management agent, the sponsor, the Borrower, if formed, and its principals
4 through a thorough analysis of their experience, credit, character, financial condition,
5 and motivation for ownership, availability of assets for closing and adequacy of
6 income for total obligations.
- 7 2. Use trade references, bank references, credit data and construction experience
8 resumes in analyzing the construction capability of the general contractor including
9 financial stability, and ability to complete the project and verify other projects in
10 progress.
- 11 3. Determine the recommended maximum mortgage amount and other key terms of the
12 loan.
- 13 4. Engage all third party consultants and analysts, review deliverables, oversee
14 packaging of the loan, and recommend loan approval (or rejection).

15 B. Duties and responsibilities of the Construction Loan Administrator during the
16 construction period are:

- 17 1. Initial distribution of mortgage proceeds into various accounts and maintain a record
18 of control and disbursement thereafter.
- 19 2. Determine construction cost (as approved by the HUD inspector), architect fees and
20 carrying charges payable under request for advances of multifamily mortgage
21 proceeds, prepare written reasons for modifications as necessary.
- 22 3. Recommend approval of construction change orders and recommend release of both
23 on-site and off-site escrow funds, citing special requirements or conditions of
24 approval as necessary.
- 25 4. Protect HUD's interest by assistance and oversight of the resolution of construction
26 disputes, delays, costs overruns, and related problems.

27 C. Major Duties and Responsibilities of HUD

- 28 1. During application underwriting:

- 1 a. Review the Lender’s mortgage credit report(s) regarding the acceptability of the
- 2 sponsor, Borrower, and its principals, and the contractor.
- 3 b. Perform the Active Partner Performance System (APPS) Electronic 2530 Property
- 4 Submission review.
- 5 c. Determine the maximum mortgage amount, financial settlement requirements,
- 6 and other key terms of the loan.
- 7 d. Determine the project’s financial feasibility and the acceptability of the market.
- 8 e. Review initial and final closing documents for compliance and acceptability.
- 9 **2. During the construction period:**
- 10 a. Review and approve the Lender’s proposed initial distribution of mortgage
- 11 proceeds.
- 12 b. Provide for construction inspections on behalf of HUD.
- 13 c. Require the Lender to ensure resolution of construction problems and disputes.
- 14 d. Approve construction change orders.
- 15 e. Review the borrower’s cost certification based on HUD allowed costs.
- 16 f. Determine the final maximum insurable mortgage.
- 17 g. Review and approve the final distribution of mortgage proceeds.

19 **2.6 Electronic Capability and Internet Access**

20
21 MAP Lenders must have electronic capability and internet access. HUD will post information
22 on its web site and will transmit messages to Lenders and to the lending community by electronic
23 mail, often with attached documents, Mortgagee Letters, or HUD Housing Notices. Much of the
24 information required by HUD must be submitted electronically.

25
26 Lender and Underwriter approval requests sent to the Asset Management and Counterparty
27 Oversight Division should include one paper copy and an electronic version.
28

2.7 Identity of Interest

A. Introduction

MAP Lenders may not have an Identity of Interest (IOI) relationship with any party related to the MAP loan being processed, unless explicitly permitted pursuant to this section and approved in writing by HUD. In this section the term “MAP Lender,” unless otherwise specified, includes the FHA-approved MAP Lender, its principals, parent company, subsidiaries, affiliates and any other related entities, and any officers, directors, partners, members or employees of the MAP Lender, its affiliates and other related parties. The term “Identity of Interest” is defined as a financial or family relationship between a MAP Lender and another party related to the MAP loan transaction that may:

1. undermine the independence and integrity of the MAP Lender’s underwriting, credit review process, and loan closing process;
2. obscure the lines between the MAP Lender’s fiduciary responsibilities to the investor and its responsibilities to HUD;
3. represent an unfair competitive advantage to the MAP Lender; or
4. represent an unfair business practice with the Borrower or any of its affiliates, e.g., due to a lack of disclosure or skewing arm’s length incentives.

For the purposes of this section, “financial relationship” includes, but is not limited to, debt or equity interests, employment, and fiduciary relationships. “Family relationship” includes, but is not limited to, spouses, parents, siblings, children, grandparents, grandchildren, aunts, uncles, mothers-in-law, fathers-in-law, brothers-in-law, and sisters-in-law.

HUD considers certain prohibited payments and/or promises by a MAP Lender to be a violation of 24 C.F.R. 200.1530(b)(7), which reads:

[p]ayment by, or receipt of a payment by, a MAP lender of any kickback or other consideration, directly or indirectly, which would affect the lender’s independent evaluation, or represent a conflict of interest, in connection with any FHA-insured mortgage transaction.

Certain payments and/or promises could further violate the following Lender’s Certificate (HUD-92434M) and the Request for Endorsement (HUD-92455M, Certificate of Lender) provision:

1 Lender has not made or offered, and shall not make or offer, any guarantees, pledges,
2 reservations of sums to become due, or other inducements to any entity or person to make
3 loans or advances which Lender would be prohibited from making under the terms of this
4 Section.

5 Prohibited Identity of Interest relationships and permissible exceptions are detailed in this
6 section and examples are provided in Appendix 2M. IOI relationships must be disclosed and
7 reported to the Asset Management Counterparty Oversight Division (AMCOD). Unless
8 otherwise specified, AMCOD will provide responses to written requests for IOI approvals
9 pursuant to this section. MAP Lenders who violate the prohibition against IOIs may be
10 subject to enforcement action by the Department, including, but not limited to, sanctions
11 under 24 CFR part 200, subpart Y (MAP Lender Quality Assurance Enforcement) and part
12 25 (Mortgage Review Board).

13 **B. Types of Identity of Interest Relationships**

14
15 1. **MAP Lender and Borrower's Team.** In MAP transactions, no IOI relationship is
16 permitted between the:

- 17
18 a. MAP Lender and
19 b. the "Borrower's Team," which includes the FHA Borrower, Borrower's
20 counsel, general contractor, subcontractor, architect, seller of the land,
21 seller of the property, a third party consultant providing reports supporting
22 the transaction, any affiliates of the Borrower's Team, or parties related to
23 the Borrower's Team.

24
25 **Exception:** Shareholder and employment interests in widely-traded public
26 companies resulting in an interest in both the MAP Lender and another party on a
27 MAP loan, which would otherwise be a prohibited IOI, may be permitted depending
28 on the specific roles and potential influence on the transaction. MAP Lenders are
29 responsible for disclosing such interests pursuant to this section, and clearly
30 demonstrating to the satisfaction of HUD that such shareholder or employee interest
31 are sufficiently remote such that they will not undermine, or give the appearance of
32 undermining, the MAP Lender's or Borrower's Team member's integrity and
33 independence in the underwriting, credit review, and loan closing process. The MAP
34 loan application may proceed only upon the prior written approval of HUD in
35 accordance with this section.

36

- 1 2. **Secondary Financing Relationships:** Secondary financing includes, but is not
2 limited to:

- 3
4 a. loans made to the project or Borrower entity;
5 b. loans made to and/or secured by upper tier ownership interests; and
6 c. other forms of mezzanine financing.
7

8 Any proposed secondary financing relationship between the Borrower and the MAP
9 Lender on a MAP application constitutes an IOI and must be disclosed in writing to
10 HUD, and the MAP Lender must receive written approval of the IOI from ACMOD
11 before submitting an application. Such approval will not be unreasonably withheld
12 provided the relationship is fully disclosed and the parties demonstrate to HUD's
13 satisfaction the relationship will not undermine the MAP Lender's integrity and
14 independence in the underwriting, credit review, and loan closing process. These
15 situations will require additional scrutiny by HUD and the MAP Lender to ensure an
16 appropriate valuation and compliance with program requirements. In cases where a
17 secondary financing IOI occurs during or after processing, it must be disclosed in the
18 manner provided in this section as soon as it is anticipated.
19

- 20 3. **Bridge Loans and Balance Sheet Loans.** An IOI is created in cases where a
21 temporary bridge loan is made by the MAP Lender to the Borrower, as well as in
22 cases where a loan on the MAP Lender's balance sheet will be refinanced using FHA
23 mortgage insurance. Bridge and balance sheet loans require disclosure of actual or
24 potential IOIs *prior to* submission of the loan application. Generally such IOIs will
25 be approved if HUD determines, based on the facts and circumstances submitted in
26 writing by the MAP Lender, that the relationship does not:
27

- 28 a. undermine the integrity and independence of the underwriting;
29 b. circumvent program requirements; or
30 c. undermine program intent, for example by facilitating cash out on either a
31 Section 223(a)(7) or a Section 223(f) loan greater than 80% LTV.
32

- 33 4. **Tax Credit Syndicator or Investor Relationship.** In all instances where there is an
34 IOI or any type of affiliation between the MAP Lender and the tax credit equity
35 syndicator or investor, the MAP loan must be processed, underwritten, and approved
36 by the MAP Lender's staff without involvement by the affiliated tax credit equity
37 syndicator's or investor's staff.

1
2 a. MAP Lenders who are approved as Supervised Mortgagees and large
3 publicly owned companies with affiliated tax credit investment entities.

4 With prior written approval from the HQ Director of MF Production,
5 certain MAP Lenders with tax credit investor affiliates may originate FHA-
6 insured MAP loans. Approval of such requests shall be conditioned on:

7 (1) the MAP Lender is a Supervised Mortgagee, as defined in Section 1-
8 2.A of HUD Handbook 4060.1, or a publicly owned company (or
9 wholly owned subsidiary of a publicly held company) subject to
10 oversight by the U.S. Securities and Exchange Commission;

11 (2) the MAP Lender submits within any calendar year no more than ten
12 (10) Firm Commitment applications for FHA transactions, not
13 including Section 223(a)(7) refinances, with an IOI in the tax credit
14 investor. The trigger is submission of the Firm Commitment
15 application, not issuance of Firm Commitments or how many are
16 processed; and

17 (3) the equity investor must remain in a purely passive role throughout the
18 term of the FHA-insured loan, including after the Tax Credit
19 compliance period ends.

20 b. MAP Lenders who are not Supervised Mortgagees or publicly held, or
21 either exceed or do not obtain approval under Section 2.7(B)(4)(a), may
22 still invest in tax credit transactions, subject to compliance and certification
23 that after the project's placed in service date, the affiliated tax credit equity
24 syndicator or investor holds no more than a twenty five (25) percent
25 ownership interest in the Borrower entity.
26

27 5. **Identity of Interest Servicing.** MAP Lenders may occasionally seek to invest in
28 multifamily projects financed by another MAP Lender using the MAP program. If
29 the Borrower has an IOI relationship with a MAP Lender, that MAP Lender cannot
30 assist in underwriting, purchase, or service the loan until after final endorsement. The
31 arrangement to assign the loan after final endorsement is subject to full disclosure
32 before processing begins, certification, approval by HUD, and development of
33 procedures implemented into each lender's Quality Control Plan (QC Plan). The risk
34 must be mitigated pursuant to the following requirements:
35

- a. The IOI relationship must be fully disclosed as a planned business practice in both lenders' QC Plans. With each application, the Underwriting MAP Lender must include a certification that includes the applicable criminal penalty warning. The warning must certify that the brokering lender had no involvement in the underwriting process, and that the referring entity had a "firewall" such that only employees of the owner/ equity investor affiliate of the broker provided information to the Underwriting MAP Lender.
- b. The Underwriting MAP Lender must have made no specific written or oral obligation to assign the loan to the IOI Map Lender after final endorsement. The Underwriting MAP Lender must retain the right to assign the loan to any servicer, or to hold the loan.
- c. The IOI Map Lender must have made no written or oral obligation to purchase the loan from the Underwriting MAP Lender. The IOI MAP Lender must retain the right to purchase, or refuse to purchase, the loan.
- d. Any dealings between the IOI MAP Lender and the Underwriting MAP Lender must be arm's length and independent at all times, including after issuance of a Firm Commitment.
- e. The IOI MAP Lender may not advise or assist the Underwriting MAP Lender in processing the loan or with making underwriting decisions in any way.
- f. The IOI MAP Lender cannot receive a broker's or consultant's fee from mortgage proceeds.
- g. HUD will only accept application packages, correspondence, and information related to the loan submitted by the Underwriting MAP Lender.
- h. The IOI MAP Lender may not hire or interact with third-party contractors other than the equity affiliate responding to inquiries from the Underwriting MAP Lender's third parties. Such interaction must be isolated by the firewall described in the Quality Control Plan.
- i. Third-Party contractors cannot have any IOI with the Borrower or the Underwriting MAP Lender.
- j. Both lenders must have appropriate and acceptable quality control practices that provide for an effective firewall. It must allow objective and independent origination and underwriting. Such practices and procedures must be defined in each MAP Lender's quality control plan, and approved by the Asset Management Counterparty Oversight Division (AMCOD).

1 6. **Inducements.** A MAP Lender cannot have arrangements with Borrowers for the
2 purpose of securing the Borrower’s business that may undermine the MAP Lender’s
3 integrity in underwriting and credit review process or provide an unfair competitive
4 advantage to the MAP Lender. Following are examples of prohibited MAP Lender
5 inducements. The MAP Lender cannot

- 6
- 7 a. provide “kickbacks” to Borrower;
 - 8 b. issue loans between affiliates of either the MAP Lender or the Borrower for
9 the purpose of meeting requirements for cash or financial capacity related
10 to the MAP transaction;
 - 11 c. pay the Borrower’s costs for third party reports;
 - 12 d. pay application fees;
 - 13 e. offer to refund application fees on unsuccessful loan applications.

14 **Note:** this list is not intended to be exhaustive. Any similar payment made by
15 MAP Lender to the Borrower to secure loan origination business must be
16 disclosed to and approved in writing by HUD.

17 The prohibition on inducements does not prevent a MAP Lender from paying for
18 updated third party reports provided the total associated cost is less than \$10,000 on
19 any particular transaction, and the updates are for third party reports already
20 submitted with a Firm Commitment application that was delayed in processing due to
21 no fault of the Borrower or MAP Lender.

22

23 7. **Gifts.** A prohibited IOI can be created when the MAP Lender, Borrower, or other
24 parties to a MAP loan solicit or accept gifts from prohibited sources based on their
25 business relationship. A gift cannot be conditioned on an agreement or obligation to
26 do business related to a MAP loan. Gifts given based on an existing business
27 relationship outside of the MAP loan must be disclosed to HUD and reviewed on a
28 case by case basis to ensure the integrity and independence of the underwriting and
29 credit review process.

30

31 8. **Charitable Donations.** From time to time MAP Lenders will make charitable
32 donations to causes that may create a conflict of interest with the Borrower and vice-
33 versa. HUD does not prohibit charitable contributions by MAP Lenders or
34 borrowers. Such contributions, however, can result in prohibited IOI relationships for
35 MAP purposes. All charitable contributions that create an IOI or a perceived IOI
36 must be disclosed in writing to HUD. An IOI is created where the Borrower, the

1 Borrower's family members, Borrower's counsel, or anyone else on the Borrower's
2 Team serve as a director, staff member, or other officer of a charitable organization
3 that receives donations from a MAP Lender. An IOI is also created where the MAP
4 Lender or the MAP Lender's family members serve as a director, staff, or other
5 officer of a charitable organization that receives donations from the Borrower, the
6 Borrower's family members, Borrower's counsel, or anyone else on the Borrower's
7 Team. If the donation to the charity was given by any party listed above and is
8 conditioned upon an agreement or obligation related to a MAP loan, it would create a
9 prohibited IOI whether such condition is written or not. The donor is responsible for
10 demonstrating, and the MAP Lender must disclose, that any charitable donations
11 between related parties with interests in a MAP loan were not conditioned on an
12 agreement related to the loan. The donor may provide documentation of monetary
13 value, history of donations to a particular charity, history of donations to a variety of
14 similar charities, or other information it deems relevant to show that the donation is
15 not based on, and would not influence the underwriting of, a MAP transaction. The
16 five main factors considered by HUD are:

- 17
- 18 a. timing;
- 19 b. monetary value or amount of the gift;
- 20 c. implicit or explicit understanding that the contribution is a condition of
21 doing the deal;
- 22 d. history of philanthropic contributions; and
- 23 e. the specific roles and relationships between the parties involved.
- 24

25 C. Disclosure Requirements

26

- 27 1. **Generally.** Disclosure is required where there is an actual IOI, the appearance of an
28 IOI, or potential for an IOI between the MAP Lender and the Borrower's Team or
29 any other party to the MAP loan. All questions and supporting documentation,
30 including any additional information requested by the Regional or Satellite Office,
31 must be submitted to HUD Headquarters. Send such requests to:
- 32

33 Director of Multifamily Housing Production, Headquarters
34 ATTN: Asset Management and Counterparty Oversight Division
35 451 7th Street, SW, Room 6134
36 Washington, DC 20410

FAX Number: (202) 401-9087

- 1
2
3 2. **IOI Discovered Before Processing.** If an Identity of Interest is identified and a
4 MAP Lender has not started processing, the MAP Lender must disclose the IOI to
5 HUD and request HUD's written approval of the IOI before continuing; or in the
6 alternative, the MAP Lender may undertake one of the following measures:
7
 - 8 a. review and submit the transaction under the traditional application
9 processing program;
 - 10 b. remove the IOI stakeholder from the transaction and process the transaction
11 using MAP; or
 - 12 c. immediately transfer the project to a new MAP Lender. The new MAP
13 Lender cannot assign the pre-application, the firm application, the mortgage
14 insurance commitment, or the insured loan back to the IOI lender prior to
15 Final Endorsement.
- 16
17
18
19 3. **IOI Discovered During Processing.** If an IOI becomes apparent during processing, a
20 MAP Lender must immediately stop processing, disclose the IOI to HUD and attempt
21 to obtain HUD's written approval of the IOI before continuing; or in the alternative,
22 the MAP Lender may undertake one of the following measures:
23
 - 24 a. transfer the transaction to the traditional application processing program.
25 The Regional or Satellite Office must completely reprocess all stages of the
26 transaction; or
 - 27 b. transfer the project to a new MAP Lender. The new MAP Lender may be
28 required by the Regional or Satellite Office to reprocess all or some stages
29 of the transaction. At no time prior to final endorsement can the new MAP
30 Lender assign the pre-application, the firm application, the mortgage
31 insurance commitment, or the insured loan back to the IOI MAP Lender.
- 32
33 4. **IOI Discovered After Firm Commitment.** Such IOIs will be presumed to reflect
34 either a lack of transparency, absence of due diligence, or negligence on the part of
35 the MAP Lender. The MAP Lender, and other involved parties, may be referred to

1 investigative or enforcement authorities. The Regional or Satellite Office must refer
2 such transactions to AMCOD.

3
4 **D. Certification.** There are three exceptions when certification is not required: loan advances
5 made in accordance with Program Obligations; notes given to evidence additional financing
6 charges owed by Borrower to the MAP Lender as authorized in the MAP Guide and as
7 disclosed pursuant to section (20)(h) of the Lender's Certificate (HUD-92434M or later
8 designation) or section 21(f) of the Certificate of Lender contained in the Request for
9 Endorsement of Credit Instrument (HUD-92455M or later designation), as applicable; or
10 lender advances made pursuant to the Security Instrument (HUD-94000M or later
11 designation). In all other circumstances, the MAP Lender must certify and agree that it:

- 12
- 13 1. does not have outstanding loans or advances to the Borrower's Team, any of the
14 sponsors, the general contractor, or the architect for any purpose directly or indirectly
15 related to the MAP loan without prior written approval of HUD;
 - 16 2. will not make any loans or advances to the aforementioned parties;
 - 17 3. has not made or offered, and shall not make or offer, any guarantees, pledges,
18 reservations of sums to become due, or other inducements to any entity or person
19 associated with the MAP loan.

20
21
22
23 **E. IOI Tax Credit Equity Syndicator or Investor Representation and Warranty.** The
24 affiliated tax credit equity syndicator or investor must not improperly influence the MAP
25 Lender on a LIHTC project. The MAP Lender and the affiliated tax credit equity syndicator
26 or investor must each provide the Regional or Satellite Office a specific Representation and
27 Warranty on each application submitted for a LIHTC project, which contains the following
28 criminal warning language:

- 29
- 30 1. The MAP Lender's Representation and Warranty must state:
 - 31 a. With respect to any LIHTC project loan that it will process under MAP:
 - 32 (1) No officer or employee of _____ (insert the name
33 of the affiliated tax credit equity syndicator or investor) or any director
34 or parent thereof will have any loan-specific or decision making
35 control or influence in _____'s (insert the name of MAP
36 Lender) underwriting of the MAP loan except by providing factual

1 information to _____ (insert the name of MAP
2 Lender) in the same manner as would be provided by an unaffiliated
3 syndicator).

4 (2) _____ (insert name of MAP Lender) will not
5 condition its agreement to provide such financing on _____
6 (insert the name of affiliated tax credit equity syndicator or investor)
7 being selected as the tax credit equity syndicator or investor for the
8 project to be financed by the MAP loan.

9 b. _____ (insert the name of MAP Lender) will notify HUD
10 promptly, in writing, during application processing of any change or event
11 which causes the foregoing Representation or Warranty to be materially
12 untrue or inaccurate.

13 c. **WARNING:** *“HUD will prosecute false claims and statements.
14 Convictions may result and/or civil penalties. (18 U.S.C. 1001, 1010,
15 1012; 31 U.S.C. 3729, 3802).”*

16
17 2. The MAP Lender’s affiliated tax credit equity syndicator or investor’s Representation
18 and Warranty must state:

19
20 a. In the regular course of its business it syndicates or invests in tax credit
21 equity investments in multifamily affordable housing projects.

22 b. With respect to any project loan that is to be underwritten by
23 _____ (insert name of MAP Lender) and in which
24 _____ (insert name of affiliated tax credit equity syndicator or
25 investor) intends to make an equity investment or sell equity to other
26 investors:

27 (1) No officer or employee _____ (insert name of MAP Lender)
28 will have any loan-specific control or influence in _____’s
29 (insert name of affiliated tax credit equity syndicator or investor)
30 processing of the sponsor’s application for tax credit equity
31 syndication or investment except by providing factual information to
32 _____ (insert the name of affiliated tax credit equity
33 syndicator or investor) in the same manner as would be provided to an
34 unaffiliated MAP Lender.

35 (2) _____ (insert the name of affiliated tax credit equity
36 syndicator or investor) will not condition its commitment to syndicate

1 or invest in the project equity on debt financing for such a project
2 being provided by _____ (insert name of MAP Lender).
3 (3) Except during the interim period prior to the placed in service date
4 during which _____ (insert name of affiliated tax credit
5 equity syndicator or investor) may make an equity bridge loan to the
6 project, neither _____ (insert the name of affiliated tax
7 credit equity syndicator or investor) nor any affiliate or subsidiary
8 thereof will hold greater than a 25 percent interest in the 99 percent
9 investor limited partnership entity (or an equivalent percentage if
10 owned as an LLC) of the borrower.

11 c. **WARNING:** *“HUD will prosecute false claims and statements.*
12 *Convictions may result and/or civil penalties. (18 U.S.C. 1001, 1010,*
13 *1012; 31 U.S.C. 3729, 3802).”*
14

15 2.8 MAP Lender Application Package

16
17 The Lender’s application should include one hard copy and an electronic version. There is no
18 specific required application form for approval as a MAP Lender, but the information submitted
19 must include the following:

- 20 A. Exhibit A. Name of applicant, address, employer identification number, contact person
21 or persons, telephone and fax number, e-mail address, branch offices for multifamily
22 business with address, telephone and e-mail address, and the FHA Mortgage ID
23 Number.
- 24 B. Exhibit B. List of names and titles of those who are authorized to bind the lender in
25 matters involving an application, underwriting and origination of insured mortgages
26 under MAP.
- 27 C. Exhibit C. Type of FHA-Mortgagee (e.g., supervised or non-supervised), type of legal
28 structure (e.g., general corporation, limited liability corporation, partnership, housing
29 finance agency or other), whether the Lender is a subsidiary of another company, and if
30 so, identification of the parent company.
- 31 D. Exhibit D. Copy of most recent financial statements submitted to HQ Lender Approval
32 Division (not applicable to supervised mortgagees).
- 33 E. Exhibit E. Narrative discussion of the applicant’s method of operation in multifamily
34 lending. This will include whether it: a) services loans, b) is an originator that sells
35 commitments or loans to others, c) originates and holds loans in its portfolio; d)
36 purchases loans from others and e) has experience in construction loan administration.

- 1 Also include the number, location and staffing of branch offices it operates, any other
2 information the applicant deems relevant in providing a clear description of its business.
- 3 F. Exhibit F. Experience of the Lender in multifamily loan origination, for both
4 conventional and FHA insured loans. List the FHA insured loans for which Lender has
5 received Firm Commitments in the last five years and the number, name, location,
6 original amount, HUD Office where processed and whether the loan is in default has
7 been assigned or an election to assign the loan to FHA has been filed. The extent of
8 conventional lending may be summarized rather than listing each conventional mortgage
9 originated in the last five years. It is important to summarize the extent of conventional
10 multifamily experience, the extent to which construction loan administration was
11 involved and the number and percentage of defaults and foreclosures. List any FHA or
12 conventional loan that was sold since origination and is serviced by another lender.
13 Report on whether the sold loan is in default, foreclosure or has been assigned to FHA.
14 Default for these purposes means a loan whose payment is more than 60 days overdue.
- 15 G. Exhibit G. Narrative discussion explaining any elections to assign FHA loans for
16 insurance benefits for any Initial Endorsements that occurred after May 1, 1995.
- 17 H. Exhibit H. Resumes of the staff that will be responsible for the submission of MAP loan
18 applications, which demonstrate that the staff has the required multifamily experience.
- 19 I. Exhibit I. Experience in construction loan administration, if intending to perform this
20 function. Identify those persons authorized to sign advances, construction change orders
21 and escrow releases.
- 22 J. Exhibit J. Information regarding:
- 23 1. Lawsuits/claims/judgments filed or issued in the last three years against the applicant
24 which:
- 25 a. Concern equal employment or lender discrimination prohibited by law, or
26 b. Are a result of, or might significantly affect, its multifamily lending business.
- 27 2. Any criminal or civil charges brought against the applicant related to the mortgage
28 lending business.
- 29 K. Exhibit K. Certification by the Lender that it will certify with each Pre-application and
30 application for mortgage insurance that it is in compliance with the identity-of-interest
31 provisions in the MAP Guide.
- 32 L. Exhibit L. An agreement that the Lender will open its files and records on FHA
33 applications for monitoring by HUD staff, including by the Asset Management and
34 Counterparty Oversight Division and the Office of Inspector General.
- 35 M. Exhibit M. A Quality Control Plan for underwriting and construction loan
36 administration, if applicable, of insured mortgages processed under MAP.

- 1 N. Exhibit N. Copy of Letter of Approval/HUD approval, Form HUD-92001-B, Branch
2 Office Notification Title I/ Title II, evidencing approval as an FHA Approved
3 Multifamily Mortgagee.

4 **2.9 Limitation on Requirements**

- 5 A. There are no additional capital requirements for MAP Lenders beyond the Department's
6 minimum net worth and liquidity requirements in 24 CFR Part 202.
- 7 B. There is no fee required by HUD for qualifying a MAP Lender.
- 8 C. MAP Lenders need to promptly notify the Asset Management and Counterparty
9 Oversight Division if there has been a change in approved signatories. MAP Lenders are
10 expected to maintain at all times the staff with the level of experience and qualifications
11 required by this MAP Guide.. Other than Underwriters, Chief Underwriters (and Deputy
12 Chief Underwriters), Construction Analyst, and Administrators, the Asset Management
13 and Counterparty Oversight Division will not approve or disapprove of individuals
14 working for MAP Lenders.
- 15 D. MAP Lenders must notify the Asset Management and Counterparty Oversight Division if
16 there has been a change of address of the home office for multifamily business, electronic
17 mail address or telephone number. If there is a change in ownership or if the lender has a
18 material change in its way of doing business, the lender must re-apply for MAP Lender
19 status. If there is a change in the MAP Lender's name or in the name the Lender does
20 business as (DBA), with no other substantive changes proposed, the Lender must notify
21 HUD of the change. The Lender must also include a certification that there has been no
22 change in ownership, principal staff or in the lender's quality control plan and
23 procedures. Lenders must also notify the Asset Management and Counterparty Oversight
24 Division if they withdraw as MAP Lenders, even if temporarily.
- 25
26

27 **2.10 Monitoring by Asset Management and Counterparty Oversight** 28 **Division**

29 The applicant for MAP Lender approval agrees that it will make its files and records available
30 to HUD or HUD's authorized contractors for such monitoring of MAP processed loans as
31 HUD determines. The Lender must retain the origination and underwriting files for seven
32 years after Final Endorsement (even if the loan has been sold.)

- 1 A. MAP Lenders are subject to monitoring and periodic on-site reviews by the Asset
2 Management and Counterparty Oversight Division to verify that the Lender('s):
- 3 1. adheres to all statutory, regulatory and MAP Guide requirements;
- 4 2. underwriting decisions are consistent with the requirements of the MAP Guide;
- 5 3. technical processing is consistent with the requirements of the MAP Guide;
- 6 4. has complied with the conditions of the Firm Commitment and the requirements for
7 Initial or Final Endorsement; and
- 8 5. has complied with the requirements for construction loan administration in the MAP
9 Guide.
- 10 B. The Asset Management and Counterparty Oversight Division will not commence reviews
11 of origination and underwriting documentation until after the Lender's first MAP Firm
12 Commitment has been issued. Please note that the Asset Management and Counterparty
13 Oversight Division reserves the right to review any loans.
- 14 C. If a MAP Lender, or an authorized employee or agent of the Lender acting under the
15 control and supervision of the Lender, commits fraud or misrepresentation, HUD reserves
16 its rights to initiate all legal action available to it under the law, including without
17 limitation action against the Lender under the contract of mortgage insurance and
18 Mortgagee Review Board requirements.
- 19 D. The review by the Asset Management and Counterparty Oversight Division is not a
20 substitute for other periodic audits and reviews by HUD, including a financial
21 management review and a review of the Lender's quality control plan as required by
22 HUD Handbook 4060.1 "Mortgagee Approval Handbook." Multifamily Production and
23 other offices within HUD may perform monitoring reviews.

24

25 **2.11 MAP Underwriter Approval Standards**

- 26 A. **Introduction:** MAP Lenders must have MAP-approved Underwriters working on the
27 transactions submitted to HUD. MAP Underwriters must be approved either by HUD or
28 by a HUD-approved Chief Underwriter that is employed by a MAP Lender. The process
29 for certifying MAP Underwriters under both the traditional model and the Chief
30 Underwriter model are outlined below.

31 HUD will continue to approve MAP Underwriters for: currently approved Low Volume
32 MAP Lenders (less than a four-year trailing average of \$100,000,000 in firm
33 commitments annually) that choose not to participate in the Chief Underwriting model,
34 new MAP Lenders with less than 4-years MAP underwriting experience (until they attain

1 sufficient experience), and MAP Lenders with suspension or termination enforcement
2 actions within the previous four years. All other MAP Lenders must approve their MAP
3 junior underwriting staff pursuant to the Chief Underwriter process set forth further
4 below.

5 HUD reserves the right to withhold or condition approval authority for MAP
6 Underwriters. The basis for Underwriter rejections or conditions to approval will be in
7 writing. Lenders may appeal rejections or conditions to approval to the Deputy Assistant
8 Secretary for Multifamily Housing Programs. Staff not involved in the original decision
9 will review and respond to the appeal.

10 **B. MAP Underwriter:** A MAP Underwriter must be a full time salaried employee of the
11 MAP Lender. The Underwriter cannot be hired on a contract basis for a particular loan
12 application. Underwriter compensation cannot be based on loan production volume, nor
13 may the underwriter be compensated in a way that may be construed as a means of
14 discouraging prudent risk management. Applicants for MAP Underwriter designation
15 may range from trainees to veteran executives with years of experience; all are expected
16 to document they have met the minimum education and experience requirements
17 expected of Underwriter trainees. The applicant must demonstrate competence and the
18 following qualifications:

19 1. **Requirements:** The applicant must have knowledge and skills in a variety of
20 financial areas, including:

21 a. General experience in banking, accounting, finance, commercial lending, and in
22 multifamily mortgage financing.

23 b. The ability to analyze corporate and personal financial statements including, but
24 not limited to, balance sheets, income statements, and statements of changes in
25 financial position and to evaluate the credit acceptability of individuals,
26 partnerships, corporations, and other entities.

27 c. A broad knowledge of lending practices for mortgages and construction loans and
28 the financial structures of individuals, partnerships, and other business entities.

29 d. The applicant must demonstrate recent, like-kind underwriting experience.
30 Recent experience shall be defined as actual underwriting experience obtained by
31 underwriting a funded multifamily loan within the previous 5 years. Like-kind
32 experience shall be defined as underwriting with comparable duties and
33 responsibilities as required under the MAP program.

1 **2. Application for HUD Approval of MAP Underwriters:** One paper copy and a
2 complete electronic version of the application are to be included with the submission.
3 One copy of the written request for approval should be submitted by a senior officer
4 of the MAP Lender with signatory authority to HUD and include the following
5 exhibits:

6 a. Resume of the Underwriter that demonstrates the specific qualifications,
7 education and the level of experience.

8
9 b. Documentation of successful completion of relevant education, and a HUD MAP
10 training certificate (or request for conditional approval to allow deferral of the
11 MAP training certificate).

12
13 c. List of loans (MAP and otherwise) processed and underwritten by the
14 Underwriter that reached Firm Commitment, certified and signed by a senior
15 officer with authorized signatory designation and by the underwriter applicant.
16 The list must contain the following warning code:

17 **Warning:** *Title 18 U.S.C. 1001, provides in part that whoever knowingly*
18 *and willfully makes or uses a document containing any false, fictitious, or*
19 *fraudulent statement or entry, in any manner in the jurisdiction of any*
20 *department or agency of the United States, shall be fined not more than*
21 *\$10,000 or imprisoned for not more than five years or both.*

22 d. Additional supporting documentation may be requested by HUD.

23 **C. Chief Underwriter:** MAP Lenders that are responsible for approving their MAP
24 Underwriters pursuant to Section 2.11.A above must designate an employee as a Chief
25 Underwriter that is HUD-approved. The designated Chief Underwriter will have
26 delegated responsibility for approving MAP Underwriters and Deputy Chief
27 Underwriters. The Chief Underwriter must certify that the MAP Underwriter or Deputy
28 Chief Underwriter is qualified according to MAP Guide requirements.

29 Ongoing eligibility to approve Underwriters will be determined by AMCOD, by
30 confirming the following: the MAP Lender is in good standing; the Chief and Deputy
31 Chief Underwriters are in good standing; the Chief Underwriter or Deputy has co-signed
32 each application submitted by a designated underwriter; and the Chief Underwriter
33 asserts in their annual certification that their Quality Control plan and underwriting staff
34 are in compliance as defined herein.

1 **1. Requirements:**

- 2 a. The proposed Chief Underwriter must be approved, in writing, by HUD.
- 3
- 4 b. The proposed Chief Underwriter must be in good standing with the Department
- 5 and in full MAP compliance, defined as not been subjected to MAP disciplinary
- 6 actions (probation, suspension or termination), over the previous four (4) years.
- 7
- 8 c. The proposed Chief Underwriter must have evidence of ten (10) years prior
- 9 underwriting experience. The experience must include a minimum of five (5)
- 10 years FHA/MAP underwriting experience, with the remaining experience to be
- 11 comprised of GNMA/FNMA, Risk Sharing, or other like-kind underwriting
- 12 experience. The experience need not be continuous, but must total 10 years. The
- 13 proposed Chief Underwriter’s application must include a listing of FHA loans
- 14 underwritten and the name(s) of the submitting Lender. At HUD’s discretion, the
- 15 individual may request that 1-year’s equivalent experience be granted for
- 16 evidence of each 10 acceptably processed firm commitment applications, for up to
- 17 years’ experience.
- 18
- 19 d. The proposed Chief Underwriter must demonstrate experience in the training,
- 20 development and oversight of Underwriter trainees. The application should
- 21 include specific experience with a list of all personnel trained.
- 22
- 23 e. The proposed Chief Underwriter may not hold a significant equity position, in or
- 24 be a principal of, the lender or any of the lender’s affiliates. Employee Stock
- 25 Ownership Plans and similar forms of compensation are permissible.
- 26

27 **2. Roles and Responsibilities:**

- 28 a. Creation and oversight of the MAP Lender’s training and development program
- 29 for underwriting personnel.
- 30 b. Approving MAP Underwriters.
- 31 c. The MAP Lender’s compliance with statutory, regulatory and programmatic
- 32 underwriting processes, requirements and standards.
- 33 d. Establishment and oversight of the MAP Lender’s Quality Control Process.

- 1 e. Reviewing, approving and cosigning all HUD mortgage insurance applications.
2 Submissions must be cosigned by the Chief Underwriter.
- 3 f. The Chief Underwriter may delegate responsibilities to the Deputy Chief
4 Underwriter, but the Chief Underwriter remains responsible.
- 5 g. Implementation of HUD recommended opportunities for improvement, to include
6 findings and observations gleaned from MAP Lender or property loan reviews.

7 **3. MAP Underwriter Approval Process and Certification:**

- 8 **a. Approval:** The MAP Lender and Chief Underwriter must provide a certification
9 that the MAP Underwriter or the Underwriter Trainee has complied with all
10 experience and training requirements detailed indetailed in this Guide. The MAP
11 Lender and Chief Underwriter must evaluate the prospective underwriter to
12 ensure and commit to the following:

13 (1) Underwriter has completed and complied with the MAP Lender's approved
14 training plan.

15 (2) Chief Underwriter has extensively reviewed the Underwriter Trainee's
16 underwriting during the training period to ensure it complies with the MAP
17 requirements, as well as accurately represents the risk associated with the
18 proposed loan.

19 (3) The Chief Underwriter has reviewed and ensured loan documentation
20 submitted to HUD during the training period was complete, and that the
21 submission did not require significant revision by HUD staff to correct errors
22 or omissions.

- 23 **b. Authorization:** The MAP Lender and Chief Underwriter shall immediately notify
24 HUD and certify that the Underwriter or the Underwriter Trainee has
25 satisfactorily completed the Designation Criteria, and has been approved and
26 designated to underwrite loans. The designee is not authorized to begin
27 underwriting until HUD is in receipt and acknowledges the MAP Lender's
28 notification and certification.

- 29 **c. Rescinding Approval:** Although HUD will rely upon designation and
30 certification by the MAP Lender, HUD reserves the right, with due cause and

1 written notification, to deny or rescind such approval, and otherwise hold the
2 MAP Chief Underwriter accountable under any of the following circumstances:

3 (1) Evidence that the Underwriter Trainee's work product during the training
4 period was unsatisfactory.

5 (2) Prior incidences of poor underwriting that display a lack of knowledge or
6 failure to exercise prudent judgment.

7 (3) The Underwriter Trainee is listed on HUD's LDP or debarment list.

8 (4) For other good cause.

9 **d. Quality Control Reviews:** Quality Control (QC) reviews prepared by the MAP
10 Lender must include confirmation that the Chief Underwriter and the Underwriter(s)
11 are approved and have satisfactorily completed all Designation Criteria, including,
12 without limitation, the MAP Lender's approved training and approval requirements.
13 During the Quality Control process, the reviewer will ensure that each loan reviewed
14 was underwritten by an approved and designated Underwriter, and, if the Underwriter
15 was approved within the previous four years, the QC review should include a review
16 of the Underwriter's approval package.

17 **C. Deputy Chief Underwriter:** The MAP Lender's Deputy Chief Underwriter can perform
18 all functions delegated to the MAP Lender's Chief Underwriter, but the Chief
19 Underwriter remains responsible for all actions of the Deputy Chief Underwriter. With
20 notice to and approval by HUD, the Deputy Chief Underwriter can also act as an interim
21 Chief Underwriter to maintain business continuity in emergency situations. In such an
22 event, the MAP Lender must obtain HUD approval for the Deputy Chief Underwriter to
23 act for the Chief Underwriter if that person does so for more than 3 months or for a
24 replacement Chief Underwriter within 6 months of the MAP Lender's initial notification
25 to HUD.

26 **1. Requirements;**

27 a. The proposed Deputy Chief Underwriter must be approved, in writing, by HUD.

28
29 b. The proposed Deputy Chief Underwriter must be in good standing with the
30 Department and in full MAP compliance, defined as not been subjected to MAP

1 and/or Section 232 disciplinary actions (probation, suspension or termination),
2 over the previous four (4) years.

- 3
- 4 c. The proposed Deputy Chief Underwriter must provide evidence of five (5) years
5 prior underwriting experience. The underwriter's experience should include a
6 minimum of three (3) years FHA/MAP underwriting experience, with the
7 remaining experience to be comprised of GNMA/FNMA, Risk Sharing, or other
8 like-kind underwriting experience. The experience need not be continuous, but
9 must total five (5) years. The proposed Deputy Chief Underwriter's application
10 must include a listing of FHA loans underwritten and the name(s) of the
11 submitting lender. At HUD's discretion, the underwriter may request that 1-
12 year's equivalent experience be granted for evidence of each 10 acceptably
13 processed firm commitment applications.
- 14
- 15 d. The proposed Deputy Chief Underwriter may not hold a significant equity
16 position, in or be a principal of, the lender or any of the lender's affiliates.
17 Employee Stock Ownership Plans and similar forms of compensation are
18 permissible.
- 19
- 20 e. Large MAP Lenders may designate more than one Deputy Chief Underwriter.
- 21
- 22

23 **2.12 MAP Lender Underwriter Trainee Approval Requirements**

24 An approved MAP Lender may train its in-house staff to be new MAP Underwriters. The lender
25 must establish a written development plan for underwriter trainees that include a combination of
26 commercial/multifamily training courses and on the job experience.

27 A: The Underwriter trainee must have successfully completed at least three underwriting,
28 finance, appraisal or environmental courses that demonstrate basic understanding of
29 multifamily underwriting concepts, one of which must be a multifamily/ commercial
30 appraisal course. These courses may be obtained through the American Bankers Association,
31 Institute of Real Estate Management, National Association of the Review Appraisers &
32 Mortgage Underwriters, the Mortgage Bankers Association of America (MBA), the
33 Appraisal Institute or any other acceptable training institution such as colleges and
34 universities. Suggested courses include *Commercial Underwriting*, *Understand Your*
35 *Construction Borrower*, *Analyzing Financial Statements*, *Commercial Real Estate Financing*
36 *and Valuation*, *Appraisal: Concepts and Applications*, *Appraisal Principles*, *Appraisal*

1 *Procedures, Basic Income Capitalization, Advanced Income Capitalization, Uniform*
2 *Standards of Professional Appraisal Practice (USPAP).*

3 Education used to meet Underwriter approval requirements must be comprehensive enough
4 to provide substantive background. In-depth specialized technical training provided by
5 recognized training institutions, trade associations, or private firms will be considered so long
6 as the content and duration of the class is analogous to a college level class. One day
7 seminars or participation in industry conferences are appropriate (and expected) for
8 continuing education, but not sufficient to meet the requirement for one of the three courses.
9 Lenders or training providers may submit a course syllabus to the Director of the Multifamily
10 Asset Management and Counterparty Oversight Division if they have a question as to the
11 sufficiency of a particular course to meet the requirement.

12 B: In addition to the training courses, HUD requires on the job training of a minimum of three
13 years continuous work experience in multifamily mortgage lending. The Underwriter trainee
14 must work on a minimum of three MAP applications that reach Firm Commitment. Only one
15 Underwriter trainee may assist the MAP approved Underwriter in completion of any MAP
16 application which should document that the trainee was supervised by only one mentor MAP
17 approved Underwriter.

18 C: The MAP approved Underwriter and the trainee must sign the Narrative Summary and the
19 processing forms. An Underwriter trainee may assist the underwriter in completion of the
20 underwriting.

21 D: The MAP approved Underwriter must accept responsibility for all aspects of the
22 underwriting of the transaction as evidenced by the Narrative Summary and processing
23 forms.

24 E: The Underwriter trainee must be a full time salaried employee of the MAP Lender. The
25 trainee cannot be hired on a contract basis for a particular loan application.

26 F: The trainee's contribution and the specific tasks performed by the trainee should be stated in
27 the Narrative Summary.

28 G: Work completed by an Underwriter trainee must be under the direct supervision of the MAP
29 approved Underwriter and it is unacceptable for the underwriter to merely sign a form or
30 document prepared by a trainee without providing proper supervision. The mentor
31 Underwriter must add a paragraph in the Underwriter Certification to certify that he/ she has

- 1 directly supervised the underwriter trainee in completion of the specific tasks in the
2 underwriting narrative and the processing forms.
- 3 H: One hard copy of the written request for approval should be submitted by a senior officer of
4 the MAP Lender with signatory authority to HUD and include the following exhibits. The
5 application should also include an electronic version.
- 6 I: A written development plan must be established for the Underwriter trainee, and submitted
7 with the application.
- 8 J: The application should include a resume of the Underwriter trainee that demonstrates the
9 specific qualifications, education and the level of experience outlined above and a HUD
10 MAP training certificate.
- 11 K: The application should include a list of MAP loans processed and underwritten by the trainee
12 that reached Firm Commitment, certified and signed by a senior officer with authorized
13 signatory designation and by the Underwriter trainee. The list must contain the following
14 warning code:
- 15 *Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or*
16 *uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner*
17 *in the jurisdiction of any department or agency of the United States, shall be fined not more than*
18 *\$10,000 or imprisoned for not more than five years or both.*
- 19 L: The application should include an electronic submission of complete documentation of each
20 MAP transaction application. The documentation signed by the trainee and co-signed by the
21 mentor underwriter must include:
- 22 1: A copy of Underwriter's Narrative that clearly identifies the specific tasks performed by
23 the underwriter trainee.
- 24 2. A copy of completed Form HUD-92264-A and other forms and / or exhibits for the type
25 of mortgage proposed that require a mortgage credit analysis. (Refer to Chapter 8 and
26 Appendix 4)
- 27 3. A copy of the Master HUD-92264.
- 28 4. An Identity of Interest Certification as required by Section 11.2.M, signed and dated by
29 the Underwriter trainee only.
- 30 A hard copy of the MAP transaction application is not required and should not be submitted.

1 M: Underwriter candidates that have successfully completed the MBA's six month FHA
2 Multifamily underwriting course will receive credit toward the experience and education
3 requirements. Completion of that course will:

- 4
- 5 1. fully satisfy the requirement to complete three courses;
- 6 2. fully satisfy the requirement to complete a MAP training course;
- 7 3. satisfy half of the three transactions requirement; and,
- 8 4. satisfy half of the three years of experience requirement.

9
10 In satisfying half of the FHA MAP Underwriter requirements in #3 and #4 above, the
11 candidate may elect to utilize the course completion to fulfill either two transactions/one
12 year, or one transaction/two years of the requirements. The applicant should submit
13 evidence of completion of the MBA MAP Underwriter course, and indicate how to utilize the
14 completion toward the requirements.
15

16 2.13 MAP Underwriter Transfers

17
18 A: MAP Underwriters that have previously been approved by HUD, and that are in good
19 standing, may apply for transfer to another approved MAP Lender.

20 B: Application: One copy of the written request for approval along with an electronic
21 version should be submitted by a senior officer of the MAP Lender with signatory
22 authority to HUD and include the following exhibits.

23 C: The application should include:

- 24 1. Resume of the underwriter that demonstrates the specific qualifications, education
25 and the level of experience
- 26 2. Evidence of prior MAP Underwriter approval.
- 27 3. Most recent HUD MAP training certificate.
- 28 4. List of MAP loans processed and underwritten by the underwriter that reached Firm
29 Commitment, certified and signed by a senior officer with authorized signatory
30 designation and by the underwriter applicant. The list must contain the following
31 warning code:

32 **Warning:** Title 18 U.S.C. 1001, provides in part that whoever knowingly
33 and willfully makes or uses a document containing any false, fictitious, or

- 1 *fraudulent statement or entry, in any manner in the jurisdiction of any*
2 *department or agency of the United States, shall be fined not more than*
3 *\$10,000 or imprisoned for not more than five years or both.*
- 4 5. A detailed list of all prior MAP loan assignments in which the Underwriter was
5 affiliated with, to include a detail of the claim's circumstances and any mitigations
6 applicable.

DRAFT

Chapter 3 Programs

3.1 General Program Requirements

This chapter contains the basic requirements for FHA multifamily mortgage insurance programs for which lenders can submit Pre-applications and applications for Firm Commitment under MAP.

The following requirements apply to *all* FHA multifamily mortgage insurance programs:

A. Regulatory Agreement. All borrowers must execute a HUD Regulatory Agreement governing the operation of the project. The Regulatory Agreement is recorded at Initial Endorsement.

B. Single Asset Entity. The mortgaged property must be the only asset of the borrower and there may not be more than one borrower entity. Natural persons or Tenants-in-Common ownership structures (including entities such as Delaware Statutory Trusts) are not permitted as mortgagor entities, though they may hold upper-tier interests. Waiver authority is reserved for the Director, Office of Multifamily Production HQ and must be obtained prior to a Multifamily Regional Center or Satellite Office accepting an application for mortgage insurance which does not conform to these prohibitions.

C. Non-recourse. The HUD mortgage note will contain a non-recourse provision as to the mortgagor entity. Notwithstanding the non-recourse provision, certain parties may be held personally liable to the extent of losses arising from certain “bad acts” and malfeasance, as set forth in the Regulatory Agreement. Such parties will be identified in the Firm Commitment.

D. Interest rate. The interest rate on a HUD insured loan is negotiated between the borrower, the mortgagee and the GNMA investor and must be locked in by the time of Initial Endorsement. Payment of discounts by the mortgagor to buy down an interest rate is acceptable during negotiations prior to Initial Endorsement. Any change in the mortgage amount due to a change in interest rate must be reflected in an amendment to the Firm Commitment before Initial Endorsement. The Mortgage Note, HUD-94001M, provides for either the same or different interest rates for the construction and permanent financing periods.

1 **E. Amortization plan.** All HUD insured mortgages must amortize through a level annuity
2 monthly payment plan (LAMP), which requires equal monthly payments of principal and
3 interest. LAMP variations are not permissible. This restriction does not prevent tranches within
4 promissory notes (e.g. A and B pieces).

5
6 **F. Loan Terms.** The maximum loan term is 40 years for new construction/substantial
7 rehabilitation, 35 years for Section 223(f) purchase/refinancing, or 75% of the remaining
8 economic life of the property, whichever is less.

9
10 **G. Prepayment Restrictions.** The Section 223(f) program limits prepayment during the first
11 five years of the loan. For other Sections of the Act, HUD permits but does not impose,
12 prepayment restrictions on insured loans. Prepayment restriction provisions cannot include HUD
13 consent as a condition to prepayment of the loan by the borrower.

14
15 **H. HUD application fee.** Under MAP (and the Section 213 program), HUD requires a fee of \$3
16 per thousand dollars of the requested mortgage amount for review of the Firm Commitment
17 application. The application fee (also known as exam fee) is considered earned at HUD acceptance
18 of the application for processing and is nonrefundable. For market rate new construction or
19 substantial rehabilitation transactions, one half of the application fee is due with the submission of
20 the pre-application package and the other half is due with the application for Firm Commitment. For
21 affordable new construction or substantial rehabilitation proposals and for any refinancing or
22 acquisition transactions, the entire amount is paid at the Firm Commitment stage.

23
24 For Section 223(a)(7) transactions, the application fee is \$1.50 per thousand dollars of the requested
25 mortgage amount.

26
27 For Traditional Application Processing (TAP) loans, the application fee is \$5 per thousand dollars of
28 the requested mortgage amount for market rate transactions and \$3 per thousand dollars of requested
29 mortgage amount if the transaction meets HUD's definition as Affordable housing.

30
31 **I. HUD inspection fee.** The HUD inspection fee is \$5 per thousand of the mortgage amount for
32 new construction and \$5 per thousand of improvement costs for substantial rehabilitation. There
33 is no inspection fee for Section 223(a)(7) projects (even if there are repairs). For loans insured
34 pursuant to Section 207/223(f), the inspection fee is the following:

- 35 1. \$30 per unit where the repairs/improvements are greater than \$100,000 in total but
36 \$3,000 or less per unit.

1 2. The greater of \$30 per unit or 1% of the cost of repairs or \$1,500, where the
2 repairs/improvements are more than \$3,000 per unit.

3 3. \$1,500 where the total repairs/improvements are less than \$100,000, which may be
4 waived by the Regional Center or Satellite Office.

5
6 **J. Mortgage insurance premium.** The mortgage insurance premiums are established by the
7 Firm Commitment and may not be changed after initial endorsement. The construction period
8 and annual mortgage insurance premiums (MIP) are based on a percentage of the mortgage
9 amount and may vary, depending on the insurance program and on the MIP schedule posted by
10 HUD each fiscal year.

11 The initial premium is payable in advance at initial endorsement. This “up front” premium is the
12 same for all market rate and affordable refinancing transactions:

13 1% for Section 223(f) loans, and ½% (50 basis points) for Section 223(a)(7) loans.

14 New Construction or Substantial Rehabilitation loans include a capitalized mortgage insurance
15 premium based on the mortgage amount and the number of years (including a portion of a year)
16 of the estimated construction or rehabilitation period.

17
18 **K. Lender fees and charges.** For programs other than Section 223(a)(7), the maximum
19 financing and placement fees the lender may charge is a total of 3.5% of the mortgage amount.
20 The 3.5% maximum can consist of any combination of origination, financing, and permanent
21 placement fees as long as it also includes the lender’s legal fee. Financing and placement fees up
22 to 5.5% are permissible in bond transactions. Third party costs (e.g., appraisal, market study,
23 PCNA, and other organization costs) may be included as mortgageable soft costs in the mortgage
24 calculations, and are not included in the limitation on lender fees. See Section 11.5 for
25 additional provisions regarding loan fees and charges.

26
27 The lender is prohibited from advancing fees for payment of discount fees on behalf of the
28 borrower. Waivers of this provision must be granted in writing by HUD Headquarters.

29
30 **L. Definition of Affordable Housing.**

31 1. Affordable housing is defined as projects meeting both of the following
32 requirements:

33 (a) projects that have a recorded Regulatory Agreement with rent and occupancy
34 restrictions or a Project-Based Section 8 contract for 90% of the units, that will be in
35 effect for at least 15 years after Final Endorsement, and

36 (b) projects that meet at least the minimum LIHTC restrictions of 20% of units at
37 50% of area median income (AMI), or 40% of units at 60% of AMI, with economic

1 rents (i.e. the portion paid by the residents) on those units no greater than LIHTC
2 rents.

3
4 2. Projects (for example mixed income properties or properties with subsidies other
5 than Project-Based Section 8) need not use LIHTCs to qualify for affordable underwriting so
6 long as they have, and are in compliance with, a recorded Regulatory Agreement imposing the
7 minimum low income occupancy and restricted rent tests above, with a term of at least 15 years
8 after Final Endorsement. The recorded Regulatory Agreement must be imposed, monitored and
9 enforced by a governmental agency.

10
11 **M. Fair Housing and Equal Opportunity.** Borrowers, management agents, contractors and
12 subcontractors must comply with HUD Fair Housing and Equal Opportunity requirements,
13 including selection of occupants, employment, and project accessibility (See 24 CFR Part 100
14 and subsequent Sections), “Affirmative Fair Housing Marketing” (24 CFR Part 200.600 and
15 Handbook 8025.1 Revision 2), and “Nondiscrimination Based on Handicap in Federally Assisted
16 Programs and Activities of the Department of Housing and Urban Development” (24 CFR Part
17 8).

18
19 **N. Previous Participation.** All principals in the proposed transaction must submit information
20 regarding previous participation in governmental housing transactions either via the electronic
21 Active Partner Participation System (APPS) or on Form HUD-2530 for approval for
22 participation in any mortgage insurance program.
23 Invitation Letters or Firm Commitments may be issued conditioned on 2530/APPS approval,
24 assuming no critical findings and that any 2530 flags can be resolved without being presented to
25 the Multifamily Participation Review Committee.

26
27 **O. Elderly or Age Restricted Housing**

28 Age Discrimination in Occupancy. “Age-restricted” has been variously defined. The
29 borrower/owner of FHA-insured multifamily properties must not discriminate against potential
30 residents based on age, families with children, or disabilities. Projects claiming exemptions for
31 housing designed for the elderly must certify compliance with the Fair Housing Act exemptions
32 detailed in 24 CFR 100.300 – 308.

33
34 1. Market Rate Projects. With the exception of Section 231 New Construction/
35 Substantial Rehabilitation projects, market rate applications for age-restricted projects
36 must have all units head of household 62 years or older, and cannot discriminate against
37 non-elderly family members including children. Units can be made available to non-

1 elderly disabled individuals and families in such projects so long as the project as a whole
2 is predominately elderly, i.e., at least 80% of overall units are occupied by elderly
3 families).

4
5 2. “Affordable” Projects. Affordable in this context means those projects with Low
6 Income Housing Tax Credits, properties with Project-Based rental subsidies for any units,
7 or properties with similar direct governmental assistance. Such properties must certify
8 compliance with the Fair Housing Act or one of its specific exemptions, and with law
9 governing Section 8 or other government assistance as applicable.

10
11 Tax credit projects without Project-Based Section 8 may use the 55+ Fair Housing Act
12 exemption, so long as the project does not discriminate against non-elderly disabled for
13 up to 20% of the units.

14
15 Section 231 projects may either conform to one of the above definitions (depending on
16 whether the project is market rate or affordable) or require all residents to be 62 years or
17 older, and allow up to 25% of the units to be occupied by non-elderly disabled
18 individuals or families.

19
20 3. Services. Projects with extensive service packages or otherwise specifically designed
21 for elderly occupancy such that all or a portion of the units would be eligible under
22 Section 232 of the National Housing Act are not eligible for MAP insurance programs.
23 The following are typical Section 232 project characteristics that are not eligible for
24 multifamily mortgage insurance or MAP processing (whether elderly or non-elderly):

25
26 a. Projects such as nursing homes, intermediate care facilities, board and care
27 homes, assisted living facilities and day care in eligible health care facilities as
28 defined under Section 232, or projects that contain comparable characteristics.

29 b. Projects in which any percentage of the units must be licensed or regulated by
30 the state or municipality in which the facility is located, other than a standard
31 rental housing occupancy or operating license.

32 c. Projects in which the borrower is required to obtain a Certificate of Need or
33 comparable documentation from the state or municipality.

34 d. Elderly housing developments that provide “continuous protective oversight”
35 services for residents in the manner defined under Section 232.

36 e. Residential accommodations including: a) programmatic restrictions on the
37 number of bedrooms per unit from efficiency through 3 bedroom units, b) non-

1 self-contained units, i.e., a bathroom shared by different residents, or c) a
2 kitchenette or less than what would constitute standard, full kitchen equipment.

3 f. Mandatory resident meal requirements.

4 g. Other resident services made a mandatory condition of occupancy.

5 h. Non-shelter and optional services included in the underwriting of net operating
6 income.

7
8 3. Meals Service Exceptions.

9 a. Refinancing HUD insured or HUD assisted properties under Sections 221(d)(4)
10 and 223(f). By final rule published in 56 FR 42798, central kitchens and the
11 provision of food services in elderly housing projects are prohibited under any
12 rental housing section of the National Housing Act, including Sections 223(f) and
13 221(d)(4). The Regional Center or Satellite Office Director may approve
14 refinancing transactions for properties, with optional meal service, in refinanced
15 Section 202 and 202/8 direct loan properties, or properties with Project-Based
16 rental assistance which are currently insured under other Sections of the Act, if
17 and only if:

18 1. Meals were provided before September 30, 1991 (the effective date of
19 the regulation) and have been continuously provided since that date, and
20 are provided on an optional (not mandatory) basis,

21 2. Income and expenses from the meal service are not included in the
22 underwriting of net operating income, and

23 3. The cost of the meals program is self-sustained by the revenue it
24 generates based on HUD's review of the project's financial statements.

25 b. Non-shelter spaces including formal dining areas with meal services for
26 projects other than those with Project-Based rental assistance and a current
27 Section 202 or HUD-insured loan are not eligible for multifamily mortgage
28 insurance, even if they are provided to residents on an optional basis.

29
30 4. Prohibition on Founder's Fees. "Founders' Fees," "admission fees," or similar
31 types of initial occupancy or entry payments are prohibited.

32
33 **P. HUD's Fiscal Procedures** are contained in HUD Handbook 4410.1 Revision 2.

34
35 **Q. Bridge or Gap Financing.** Bridge financing is a short term loan that is secured by the
36 property, or by a pledge of an interest in the borrowing entity, pending the start of a long-term
37 permanent loan. Bridge loans that are secured by the property (as distinguished from bridge loan

1 used to fund equity during construction and which is secured by ownership interests), are
2 acceptable only in instances of Insurance Upon Completion and before the start of the FHA-
3 insured permanent financing. Bridge financing is permitted so long as the bridge loan is repaid
4 at the time of permanent loan closing, or converted in whole or in part to Secondary Financing
5 within the allowed limits for the FHA program. Bridge loan or other debt intended to increase
6 the FHA-insured mortgage or circumvent outstanding program requirements will not be
7 recognized as existing indebtedness in the cost basis. Gap financing is a loan that may be
8 secured by a subordinate lien behind the permanent first mortgage to provide additional capital
9 funds for the project; it must meet the Guide's requirements for secondary financing.

10
11 **R. Secondary Financing.** HUD insured mortgages must be first liens. Secondary liens are
12 permitted under certain conditions. Chapter 8 contains the requirements for secondary financing.

13
14 **S. Commercial Space.** Commercial facilities may be included in a mixed use project, subject to
15 programmatic space and income limitations. See Chapter 7 and Appendix 3A for further
16 guidance.

17
18 **T. Military Impacted Areas.** HUD generally will not insure mortgages in designated military
19 impacted areas unless HUD determines that demand from nonmilitary households is sufficient to
20 sustain occupancy in both the insured project and the market as a whole. Section 238(c) of the
21 National Housing Act authorizes the provision of insurance in military impacted areas upon
22 certain findings by the Department of Defense (DOD) and HUD HQ. In such areas, borrowers
23 should be encouraged to contact DOD for other potential programs administered by DOD which
24 could provide alternative sources of financing for the proposed project. Section 238(c) loans are
25 not eligible for MAP but may be processed under TAP.

26
27 **U. Student Housing.** Insured projects cannot be designed solely for student occupancy,
28 although students and families are eligible occupants of insured family housing projects. Insured
29 loans on projects in college areas must be underwritten at rents that are comparable to family
30 housing in the area. Loans cannot be underwritten with rental rates assuming multiple student
31 occupants in a unit that would result in a processing rent higher than a typical family apartment.

32
33 **V. Real Estate Requirements.** The insured mortgage must be on real estate:

- 34 1. Held in fee simple, or
- 35 2. Under a lease with a term of at least (i) ninety-nine years which is renewal, (ii) 50
36 years from the date the mortgage is executed, or (iii) for a period of not less than
37 10 years more than the loan maturity date, dependent upon the SOA.

1
2 **W. Transient Housing/Hotel Services Prohibition.** Section 513 of the National Housing Act
3 prohibits the use of the insurance programs for transient or hotel purposes. Leases for less than
4 30 days are prohibited and occupants cannot be provided with hotel services such as maid
5 service, furnishing and laundering of linens, room service and bellboys. This also applies to any
6 commercial space funded by the mortgage.

7
8 **X. Operating Deficit.** An operating deficit escrow is required on all applications for new
9 construction and substantial rehabilitation to provide funding for operating expenses and debt
10 service when net income is not available during the initial lease up and stabilization period. A
11 debt service escrow may also be required on Section 223(f) proposals where analysis requires it.
12 This escrow is not mortgageable and unused portions will be returned to the borrower. See
13 Chapter 8 for more detail.

14
15 **Y. Short-Term Lease Premiums.** Projects that provide leases with terms that are less than 30
16 days are not eligible for HUD-insured financing under any circumstances. Treatment of income
17 from other short-term leases, i.e., furnished units, corporate or business short-term leases, may be
18 considered to the extent that it is present in the local market so long as for periods greater than 30
19 days. The actual number of furnished or corporate/business units generally may not exceed 10%
20 of the units and must be approved by Asset Management at the time of underwriting. See
21 Chapter 7 (Section 7.7.M) for short-term lease underwriting and valuation instructions, and other
22 requirements.

23
24 **Z. Replacement Reserve.** A replacement reserve is a set aside funded at closing and/or from
25 project operating income to pay for the eventual replacement of short-lived or capitalized
26 physical assets. See Section 7.8 for the minimum annual replacement reserve requirements for
27 all program types and Appendix 5G for guidance on completing a Project Capital Needs
28 Assessment (PCNA) for all insured projects every 10 years. Handbook 4350.4, Chapter 2
29 Servicing Manual, details the lender's responsibility on managing funds held for the project and
30 describes the liquidity, draws and investment requirements.

31
32 **AA. Developer Fees.** In Cost Controlled mortgages for FHA New Construction and Substantial
33 Rehabilitation Programs (other than Section 231 Substantial Rehabilitation and Section 241(a)),
34 Builder Sponsor Profit and Risk Allowance (BSPRA, or SPRA) is allowed. BSPRA is a
35 mortgageable cost but not a source of cash. For affordable programs (Low Income Housing Tax
36 Credits, RAD, Section 202 refinancings), a Developer Fee may be mortgageable so long as

1 BSPRA or SPRA is not included. A summary of Developer fees for various FHA and assisted
2 programs is included in Appendix 3B.

3
4
5 **BB. Condominiums.** A project which was built and plotted as condominiums, but is now
6 operating as a rental project, may be considered under Section 223(f) if the condominium regime
7 is converted to a single owner with no individual unit ownership and the property meets the other
8 program guidelines, including the minimum occupancy standards. Condominium regimes are
9 similarly permitted under new construction and substantial rehabilitation proposals that meet
10 these same requirements.

11
12 Condominium ownership regimes and plots may be recorded if the property is otherwise
13 operated as a rental project with a single ownership entity owning all the apartments. Separate
14 condominium units may be established for commercial use and for housing use which must
15 include all the residential apartments. The insured loan must be secured by a mortgage on the
16 rental apartment portion and any mortgageable commercial space. Joint use and maintenance
17 agreements and easements between the insured portion and any separately demised
18 condominium portion must be defined, and all condominium fees must be equitably allocated.

19
20 The Regional Center or Satellite Office Director may consider a waiver for a condominium
21 building with a limited number of individually owned units (i.e. 10% or less of total units) if all
22 the owned units are located in a separate building or in a separate section of a single building
23 apart from the rental units. HUD will not consider a waiver if any ownership units are
24 interspersed with the rental units.

25
26 **CC. Environmental Review.** HUD has responsibilities to comply with various environmental
27 laws and regulations. Lenders' submission requirements assist in this review, as detailed in
28 Chapter 9, Environmental Review.

29
30 **DD. Underwritten Occupancy.** Underwritten vacancy rates will be at the greater of the
31 minimums below and actual levels. The MAP Lender's third party Appraiser should use actual
32 vacancy rates, which are generally expected to be no lower than the below rates. The minimum
33 vacancy rates for underwriting and sizing debt service mortgages are as follows:

34
35

<i>Minimum Vacancy and Collection</i>	<i>Property Type</i>
---	----------------------

<i>Loss Rate</i>	
3%	<ul style="list-style-type: none"> • HUD-assisted property with HAP contract on 90% or more of the units; <u>or</u> • In-place rehab with greater than 90% occupancy and greater than 90% of the units set aside as LIHTC units, with attainable tax credit rents at least 10% below market (i.e. a “discount to market”).
5%	<ul style="list-style-type: none"> • 80% of the units are set aside as LIHTC units, with attainable tax credit rents at a 10% discount to market.
7%	<ul style="list-style-type: none"> • LIHTC without a 10% discount to market; or • 20% or more of the units are Market Rate.

3.2 New Construction/Substantial Rehabilitation Program Requirements

Sections 220, 221(d)(4), 231 and 241(a) of the National Housing Act provide FHA multifamily mortgage insurance for the new construction or substantial rehabilitation of multifamily rental apartment properties. Section 213 is available for the new construction or substantial rehabilitation of Cooperatives, however those transactions will be processed under Traditional Application Processing (TAP).

The following requirements apply to *all* FHA New Construction/Substantial Rehabilitation multifamily mortgage insurance programs:

A. Properties must have 5 or more residential units with complete kitchens and baths. (Section 231 requires at least 8 units.) Group Homes are not eligible for FHA multifamily mortgage insurance. SRO properties will only be considered if they have existing Project based Section 8 contracts in place.

B. HUD can insure both the construction and permanent loan periods (Insurance of Advances) or just the permanent loan period (Insurance Upon Completion). Davis Bacon wage requirements apply to new construction and substantial rehabilitation transactions for both Insurance of Advances and Insurance Upon Completion.

1 **C. New Construction** transactions finance improvements where no construction work has been
2 done to the site prior to Initial Endorsement. See Chapter 5 for additional information and
3 exceptions.

4
5 **D. Substantial Rehabilitation** transactions finance repairs and rehabilitation of existing
6 properties which are or have been previously occupied. Projects in which construction of above
7 ground improvements was started but not completed or inhabited are not eligible. The definition
8 of substantial rehabilitation is based on either a per unit threshold for the cost of rehabilitation, or
9 substantial replacement of two major systems. See chapter 5.

10
11 **E. Cost Certification.** The borrower must submit a cost certification prepared by an independent
12 CPA upon completion of construction or substantial rehabilitation. The mortgage amount that is
13 finally endorsed for insurance after completion of construction can be reduced based upon HUD
14 review of the cost certified amounts. General contractors or subcontractors are required to submit a
15 cost certification if there is an identity of interest with the borrower. See Chapter 14 for tax credit
16 project cost certification procedures and exemptions.

17
18 **F. Federal Labor Standards.** The general contractor and all subcontractors for FHA-insured
19 new construction or substantial rehabilitation transactions are required to comply with federal
20 wage and reporting requirements per the Davis Bacon Wage Act. Davis Bacon requires the
21 payment of prevailing wage rates and the submission of weekly certified payroll reports.
22 Prevailing wage schedules may be obtained from the Regional Center or Satellite Office. The
23 one exception to this requirement is for Section 241(a) loans in which the underlying first
24 mortgage is a Section 223(f) insured loan (and the Section 223(f) did not refinance a project
25 originally insured with an FHA new construction or substation rehabilitation loan.)

26
27 **G. Assurance of Completion.** The general contractor shall provide an assurance of completion
28 of construction on forms approved by HUD. See Section 8.7 for the specific requirements.

29
30 **H. Absorption Period.** The absorption period used in estimating market demand for proposed
31 newly constructed or substantially rehabilitated units is 18 months. Larger projects may phase
32 additional units under a separate application for mortgage insurance. An exception to the 18
33 month limitation on the absorption period may be considered by the Regional Center or Satellite
34 Office Director for large high rise buildings which will be evaluated based on their own merit
35 and will require a larger initial operating deposit.

36

1 **I. Marketing, Leasing and (if applicable) Relocation Plan.** All projects which require
2 absorption of units at economic rents to achieve break-even occupancy must submit a detailed
3 marketing and leasing plan, and budget that has been reviewed and confirmed by the proposed
4 property management company. The plan must discuss when marketing efforts will begin, when
5 the leasing office and model units will be opened, how the leasing office will be staffed, and the
6 project's marketing and advertising strategy. The plan must address timing of the construction
7 progress schedule with respect to egress and ingress into the project, landscaping and access to
8 amenities. These items are in addition to those required by the Affirmative Fair Housing
9 Marketing Plan. For substantial rehabilitation projects involving temporary relocation or
10 displacement of residents, the plan must address details of timing, funding and management of
11 the relocation process.

12
13 **J. Working Capital Escrow.** The Working Capital Escrow is designed to cover accruals of
14 taxes, insurance, and interest in the case of construction delay, construction contingencies for
15 cost overruns and change orders, and other miscellaneous expenses which are not included in the
16 mortgage, and is required for new construction and substantial rehabilitation proposals. See
17 Section 8.13 for general requirements and Section 12.15.C for working capital escrow release
18 instructions.

19
20 **K. Furniture, Fixture and Equipment (FF&E) in Cost Basis.** Reasonable costs of Furniture,
21 Fixture and Equipment may be included in mortgageable project costs and in the Reserves for
22 Replacement for new construction and substantial rehabilitation proposals. See Chapter 5,
23 Section 511.D.4.i for FF&E examples and guidance. All funded FF&E will be subject to HUD's
24 security instruments.

25
26 **L. Elderly Developments.** New construction or substantial rehabilitation of apartments
27 specifically designed with occupancy restricted to the elderly age 62 and over should be
28 processed under Section 231. Age restricted projects are not eligible under Section 220. Age
29 restricted Multifamily projects may be considered under other Sections of the Act (e.g., Section
30 221(d)(4) or 223(f)) so long as they do not discriminate against non-elderly family members and
31 do not offer mandatory meals or other services as specified in Section 3.1.O above, or for
32 Affordable projects with no Project based Section 8 subsidy meet other specific defined Fair
33 Housing Act exemptions.

34
35 **M. Occupancy Preference.** Sponsoring nonprofit organizations such as labor unions,
36 professional groups, religious organizations, and fraternal or civic organizations, may give
37 preference to their members, provided membership in the organization is open without regard to

1 race, color, national origin, sex, sexual orientation, disability or religion. However, sponsors
2 cannot restrict occupancy solely to their members. Similarly, projects (regardless of ownership)
3 may target occupancy to various demographic groups (such as “workforce housing”) so long as
4 there is sufficient and sustainable market and Affirmative Fair Housing Marketing Plans and
5 other management plan exhibits demonstrate the property will not discriminate against any
6 particular race, color, national origin, sex, sexual orientation, disability or religion.

7
8 **N. Builder and Sponsor’s Profit and Risk Allowance (BSPRA) and Sponsor’s Profit and Risk**
9 **Allowance (SPRA) are allowed (but not required) for new construction and substantial**
10 **rehabilitation applications under Sections 221(d)(4), 220, and 231 for profit motivated and**
11 **limited distribution borrowers. Non-profit borrowers are eligible for a developer’s fee, or may**
12 **apply as a for-profit entity for purposes of applying for FHA mortgage insurance, as provided in**
13 **Chapter 8.**

14
15 1. The BSPRA allowance will be credited against the borrower’s required equity
16 contribution. To use BSPRA, there must be an identity of interest between the borrower
17 and general contractor and there must be no paid builder’s profit contained in the
18 mortgage calculation. For new construction, BSPRA is 10% of the estimated cost of: on
19 site improvements, structures, general requirements, general overhead, architect's fees,
20 carrying charges and financing, legal, organizational and audit expenses (total of lines 50,
21 63 and 67 in Section G. of Form HUD-92264), exclusive of land. For substantial
22 rehabilitation projects, BSPRA is 10% of the above costs exclusive of the as is value of
23 the existing structure.

24
25 2. SPRA may be included in replacement cost where no identity of interest exists
26 between the general contractor and borrower, or where there is an Identity of Interest but
27 the borrower and general contractor have agreed a general contractor profit instead of
28 BSPRA. SPRA is 10% of the total estimated cost of: architect's fees, carrying and
29 financing charges, legal, organizational, and audit expenses.

30
31 **O. Energy Efficiency.** New construction or substantial rehabilitation projects must comply with
32 the International Energy Conservation Code (IECC) 2012, or in the case of multifamily high
33 rises, American Society of Heating, Refrigeration and Air-conditioning Engineers, ASHRAE
34 Standard 90.1 2010, *[subject to publication, or use the IECC 2009 and ASHRAE 2007 standards if not*
35 *published by the time the MAP Guide ready to publish in final form]* or applicable successor codes [as
36 adopted by the Secretary pursuant to the requirements of the Energy Independence and Security
37 Act of 2007, Public Law 110-140 or successor requirements. When a PCNA includes an energy

1 audit meeting the requirements of ASHRAE level II, and when the assessment includes potential
2 future savings if recommended energy efficiency measures are adopted, up to 75% of projected
3 energy savings may be recognized.

4

5 **P. Cost vs. Value.** Most FHA multifamily new construction and substantial rehabilitation
6 programs are based on cost rather than value when sizing the mortgages (in Criterion 3 of Form
7 HUD-92264A). Exceptions are Sections 231 and 241(a) programs which have value limitations.
8 For substantial rehabilitation under all Sections of the Act, the “as is” value of the project is a
9 component of the cost. “As is” value of a substantial rehabilitation project will be the lessor of
10 the value “as is”, reflecting actual occupancy and any restrictions on NOI, or the purchase price
11 at closing if it is an arms-length acquisition transaction.

12

13 **3.3 Section 221(d)(4) Mortgage Insurance for Rental and Cooperative** 14 **Housing - New Construction and Substantial Rehabilitation**

15 Section 221(d)(4) insures mortgages for the new construction or substantial rehabilitation of
16 rental housing. In addition to the general requirements in Sections 3.1 and 3.2, the requirements
17 in this section apply to the Section 221(d)(4) program:

18

19 **Maximum Loan Ratios and Debt Service Coverage Ratios.** The following loan ratios and
20 percentages control the loan amount and are the mortgage criteria detailed on the Form HUD-
21 92264-A, Supplement to Project Analysis. The lowest of the mortgage criterion controls the loan
22 amount.

1 Section 221(d)(4)

2 New Construction and Substantial Rehabilitation

3 Criteria 1:

4 Loan Amount Requested in the Application. The requested application amount may be amended
5 when appropriate, e.g. when a higher mortgage is supportable due to a drop in rates.

6 Criteria 3:

7 Amount Based on Replacement Cost: The applicable percentage of the estimated replacement
8 cost for new construction or the applicable percentage of the sum of the estimated replacement
9 cost for substantial rehabilitation plus the “as is” value of the property before substantial
10 rehabilitation is:

- 11 a. 90% - for projects with 90% or greater rental assistance;
- 12 b. 87% - for projects that meet the definition of Affordable Housing; or
- 13 c. 85% - for market rate projects

14 Criteria 4:

15 Amount Based on Limitations per Family Unit: Where percentages are required, enter the same
16 percentage applied under Criteria 3. See Chapter 8 for complete details and the MF Housing
17 website: <http://www.hud.gov/offices/hsg/mfh/hicost/hicost.cfm> on information for per family
18 unit limitations and the High Cost Percentage by jurisdiction.

19 Criteria 5:

20 Amount Based on Debt Service Ratio (DCR) (ratios are rounded for presentation purposes):

- 21 a. 90% (1.11 DCR) – for projects with 90% or greater rental assistance;
- 22 b. 87% (1.15 DCR) – for projects that meet the definition of Affordable
23 Housing; or
- 24 c. 85% (1.176 DCR) - for market rate projects
- 25

3.4 Section 220 Mortgage Insurance for Rental Housing for Urban Renewal and Concentrated Development Areas - New Construction and Substantial Rehabilitation

Section 220 insures mortgages for the new construction or substantial rehabilitation of mixed use housing projects in urban renewal areas, code enforcement areas and other areas where local governments have undertaken designated revitalization activities.

In addition to the general requirements in Sections 3.1 and 3.2, the following requirements apply to Section 220:

A. Eligible Areas. The property must be located in either a concentrated development area approved by the Multifamily Regional Center or Satellite Office, or one of the following:

1. Existing slum clearance and urban redevelopment projects covered by a Federal aid contract before the effective date of the Housing Act of 1954.
2. An approved urban renewal area under Title I of the Housing Act of 1949.
3. Disaster urban renewal projects assisted under Section III of the Housing Act of 1949 as amended.
4. An area of concentrated code enforcement being carried out under Section 117 of the Housing Act of 1949.

The Multifamily Regional Center or Satellite Office will consider proposals in concentrated development areas in which concentrated housing, physical development and public service activities are being carried out in a coordinated manner, pursuant to a locally developed strategy for neighborhood improvement, conservation or preservation. Locally developed strategies may be informal, but must:

- a. Provide for a combination of physical improvements, necessary public facilities and services, housing programs, private investment and citizen self-help activities appropriate to the needs of the area,
- b. Coordinate public and private development efforts, and
- c. Provide sufficient resources to produce substantial long-term improvements in the area within a reasonable amount of time, taking into account the severity of the area's problems.

- 1 B. Commercial Facilities. Commercial space may be included if it will serve the needs of the
2 project residents and other residents of the area. Commercial space is limited to 20% of total
3 net rentable area and commercial income to 30% of effective gross project income.
4 See Section 7.7 and Section 7.8 for separate appraisal and market study analysis
5 requirements where commercial facilities are included in a project.
6 C. Maximum Loan Ratios and DCRs. The controlling mortgage criteria for Section 220 loans
7 are the same as for the Section 221(d)(4) program, detailed above.
8 D. Builder/Sponsor Profit and Risk Allowance (BSPRA). See definition of BSPRA in Section
9 3.4.
10 E. Sponsor Profit and Risk Allowance (SPRA). See definition of SPRA in Section 3.4.
11 F. Elderly Developments. Apartments specifically designed for the elderly and/or limited to
12 elderly occupancy are not permitted under this Section.

13

14 **3.5 Section 231 Mortgage Insurance for Rental Housing for Elderly Persons** 15 **– New Construction and Substantial Rehabilitation**

16

17 Section 231 insures mortgages for construction and substantial rehabilitation of rental housing
18 for elderly persons (aged 62 or older) and/or persons with disabilities. A project must comprise
19 8 or more new or substantially rehabilitated units designed for occupancy by elderly persons and
20 may include family units for occupancy for persons who qualify as handicapped.

1 A. Definitions/Explanations of Terms:

2 1. Elderly Person. A person aged 62 or older. For Section 231 occupancy, other than for
3 units designed for the use and occupancy of handicapped persons and their families for
4 up to 25% of the units, all persons living in a unit must be age 62 or over, or the project
5 must certify compliance with the Fair Housing Act and claim and exemption as described
6 in Sections 3.1.O and 3.2.L above.

7 2. Handicapped [“disabled”] Person. A person who has a physical impairment which:

8 (1) Is expected to be of a long-continued and indefinite duration;

9 (2) May substantially impede his/her ability to live independently; and

10 (3) Is of such a nature that his/her ability to live independently could be
11 improved by more suitable housing conditions.

12 B. Room Lay Out, Design and Special Amenities. Particular attention is to be given to room lay
13 out and unit design to assure they are consistent with the needs of the elderly or handicapped
14 market.

15 C. BSPRA or SPRA allowances are eligible under Section 231 new construction transactions so
16 long as there is no Developer Fee. These allowances are not available for Section 231
17 substantial rehabilitation transactions, which may be constrained by value. See Section 3.4.U
18 for an explanation of these allowances.

19 D. Maximum Loan Ratios and DCRs. The controlling mortgage criteria for Section 231 loans
20 are the same as for the Section 221(d)(4) program, detailed above, with the exception of criterion
21 3 for substantial rehabilitation loans, which is controlled by the applicable percentage of “as
22 rehabilitated” value (not cost).
23

24 **3.6 Section 241(a) Mortgage Insurance for Supplemental Loans for**
25 **Multifamily Projects**
26

27 A. Eligibility. Section 241(a) is now a MAP-eligible program. It provides secondary financing
28 for improvements or additions to properties with a HUD-insured first mortgage which need
29 repairs, substantial rehabilitation, or additional units.
30

1 1. Projects with HUD held debt (as opposed to FHA-insured), or Risk Share financing are
2 not eligible to apply for Section 241(a) loans.

3
4 2. Improvements, such as fire safety improvements, energy conservation measures,
5 updated security systems, or substantial rehabilitation may be financed with a
6 Supplemental Loan. As a general rule, repairs to an existing project that are not
7 extensive enough to be classified as substantial rehabilitation should be paid for by funds
8 other than a Supplemental Loan. However, if there are major repairs required and other
9 funds are not available in the replacement reserve, the sponsor may seek a Supplemental
10 Loan under Section 241(a).

11
12 3. Construction of additional units, or expansion of the foot print of the existing building,
13 is allowed. Such work may be completed on the existing parcel secured by the first
14 mortgage, or a contiguous or nearby parcel acquired and included in an amendment to the
15 existing first mortgage security documents.

16
17 B. Term. The Section 241(a) loan should generally be coterminous with the underlying FHA-
18 insured first mortgage if that loan has more than 25 years remaining on its term. If less than 25
19 years remain on the term of the first mortgage, HUD will consider an amortization period up to
20 40 years regardless of the underlying first mortgage's amortization period so long as the term is
21 no greater than 75% of the project's remaining useful life.

22
23 C. Equity requirement and controlling mortgage criteria. The owner is required to contribute at
24 least 10% of the total development cost of the transaction. Existing reserve for replacement
25 deposits in excess of the Initial Deposit requirement concluded in the PCNA and underwriting
26 may be used to meet the equity requirement. Similarly, land equity from adjacent or nearby
27 parcels added and incorporated into the existing first mortgage security and additional cash
28 contributions can be used to meet the 10% equity contribution requirement. Residual Receipt
29 account funds (e.g., from surplus Section 8 funding) cannot be used to meet equity requirements.
30 Imputed equity representing the difference between the "as is" value of the project and the
31 existing indebtedness is not available to meet the equity requirements. The HUD Form 92264
32 and 92264A should recognize only the cost of the addition or improvements but, should include
33 all (i.e. the existing and proposed) project Net Operating Income (NOI) in Criterion 5 of Form
34 HUD 92264A. A supplemental analysis comparing the historical and proposed NOI should be
35 included as an attachment to the HUD-92264.

36
37 Criterion 3 – Loan to Value / Cost: A Section 241(a) supplemental loan is limited by statute to
38 90% of the HUD-estimated value of the improvements, additions or equipment, regardless of the
39 Section of the Act insuring the underlying first mortgage. The cost of the repairs and transaction
40 costs (including the acquisition price of an adjacent or nearby land parcel) will be recognized as

1 the value, so long as any additional land purchased or contributed is no more than the fair market
2 value. Regardless of the Section of the Act of the underlying first mortgage, neither BSPRA nor
3 SPRA may be recognized. The cost of the transaction can and should include builder's profit
4 (regardless of whether there is an Identity of interest.)

5
6
7 **Criterion 4: - Statutory Limits.**

8 The Supplemental Loan, when added to the outstanding balance of the mortgage covering
9 the project or facility, may not exceed the maximum statutory limitation applicable to the
10 building and unit type for the Section of the Act under which the existing first mortgage
11 is insured.

12
13 **Criterion 5 – Debt Service Coverage Ratio.** The maximum loan amount under this
14 criterion is debt service (in combination with the first mortgage payments) supported by
15 90% of projected NOI.

16
17 **D. PCNA, Plans and Specifications, and Cost Estimate requirements.** A complete PCNA,
18 including reserve for replacement analysis, is required for all Section 241(a) loans. The repair
19 list should be supplemented with Plans, Specifications, and Cost analysis per requirements for
20 Section 221(d)(4) or other new construction or substantial rehabilitation loan programs.

21
22 **E. Davis Bacon Wage Act applicability.** Davis Bacon Wage requirements apply for all Section
23 241(a) loans except those in which the underlying first mortgage is a Section 223(f) loan (or a
24 Section 223(a)(7) loan which refinanced a Section 223(f) loan).

25
26 **F. Insurance of Advances or Insurance upon Completion.** Either approach is acceptable.
27 Construction advances for any Supplemental Loan may be insured; the minimum amount of
28 advance that may be insured is \$200,000. Mortgageable contingency and construction draw
29 retainage are subject to the same requirements as other New Construction / Substantial
30 Rehabilitation programs.

31
32 **G. Environmental Assessments.** An environmental assessment per Chapter 9 is required for
33 Section 241(a) loans used to fund significant improvements, additional units or an increase in a
34 building footprint.

35
36 **H. Working Capital and Operating Deficit Reserves.** The working capital and operating deficit
37 reserves requirements are the same as those of the Section 221(d)(4) program. The lender can
38 recommend, and HUD may approve, waiving the requirements when appropriate on specific
39 cases.

3.7 Section 207/223(f) Mortgage Insurance for Purchase or Refinancing of Existing Multifamily Rental Housing

Section 207/223(f) insures mortgages for the purchase or refinancing of existing rental housing which may have been financed originally with conventional mortgages or equity. The use of Section 223(f) for Cooperative Multifamily Housing is described in Chapter 17. Properties requiring substantial rehabilitation are not eligible for this program. HUD requires completion of critical repairs before endorsement of the mortgage and permits the completion of non-critical repairs after endorsement.

- A. Eligible Properties. The property must contain at least 5 residential units. Market Rate properties must have been completed or substantially rehabilitated at least 3 years before the date of application. Projects with either Low Income Housing Tax Credits or 100% (> 90%) Project-based Section 8 must have at least 6 months of sustaining occupancy (break even operations).

Properties that were constructed or substantially rehabilitated with HUD-insured multifamily mortgages, and the latent defects guarantee period has expired, are exempt from the 3-year rule. Projects with additions completed less than 3 years before the application are eligible for refinancing as long as the size and number of units in the addition are not larger than the size and number of units in the original project.

B. Ineligible properties.

1. Manufactured home parks and group homes are not eligible under this Section.
2. Properties whose required repairs are so extensive that they meet the threshold for substantial rehabilitation are not eligible under this Section.
3. Properties with meal services or other features typical of or unique to Retirement Service Centers. Although, there is a potential exception to allow otherwise prohibited services for refinancing Section 202 properties or HUD-insured properties with Project-Based rental assistance so long as they are offered on an optional basis, projects with mandatory meal service are not eligible.

- C. In addition to the general requirements in Section 3.1, the following requirements apply to Section 223(f) when used for acquisition or refinancing:

- 1) Any property acquired by the borrower before the date of the mortgage insurance application shall be treated as a refinance transaction;
- 2) Any property acquired the borrower after the date of the mortgage insurance application shall be treated as a purchase; and
- 3) In a purchase transaction, any identity of interest, however minor an interest, between seller and purchaser requires the application to be processed as a refinance. (Acquisitions to facilitate Low Income Housing Tax Credit transactions are an exception to this requirement.)

D. Repairs.

1. Critical repairs must be performed prior to endorsement.
2. Non-critical repairs, approved by HUD, may be completed after endorsement with work write-ups sufficiently detailed to facilitate inspections, schedules for completion of repairs, complete bids on work items greater than \$25,000, and a financial escrow equal to 120% of the non-critical repair costs that must be established at closing. The 20% escrow above the 100% of the non-critical repair cost is non-mortgageable and may be reduced to 10% for affordable transactions.

E. Fair Housing Act Noncompliance. Any property available for first occupancy after March 13, 1991, that is in noncompliance with Fair Housing Act design and construction requirements, must, as a condition of insurance, be modified/retrofitted to comply with Fair Housing Act accessibility guidelines. HUD may approve the modifications/retrofits to be completed after endorsement with appropriate financial escrows at closing, and the work must be performed in accordance with instructions in Section 3.2. J and Appendix 5C.

F. Elderly developments. Existing projects specifically designed for the elderly, (i.e. head of household age 62 and over but cannot discriminate against non-elderly family members unless otherwise exempt from the Fair Housing Act prohibition on discrimination as discussed in Section 3.1.O and 3.2.L above) are eligible under Section 223(f) as long as the property does not contain the features of the Section 232 program described in Section 3.2.

G. Prior Defaults/Claims. HUD does not prohibit applications for mortgage insurance for formerly HUD-held loans but will not accept any application from a borrower/principal who has not proven to be a good business partner with HUD or for a property which has proven to be unsuccessful in the past. The lender should accept such applications only after they have documented the economic, physical, operational or management changes that have occurred

1 which would justify an application for new insurance. A concept meeting prior to submission is
2 required to address the past experience of the loan and of the borrower/principal including past
3 Regulatory Agreement compliance.

4
5 H. Labor standards. Davis Bacon prevailing wage requirements do not apply to Section
6 207/223(f).

7
8 I. Prepayment Provisions and Prohibition. The National Housing Act prohibits prepayment of
9 loans insured under Section 223(f) for 5 years from the date of endorsement for insurance except
10 where at the time of prepayment:

- 11 1. The borrower enters into an agreement with HUD to maintain the property as rental
12 housing for the remainder of the specified 5 year term;
- 13 2. HUD determines that the conversion of the property to a cooperative or condominium
14 ownership is sponsored by a bona fide resident organization representing the majority of
15 households in the project;
- 16 3. HUD determines that continuation of the property as rental housing is unnecessary to
17 assure adequate rental housing for low and moderate income residents of the community;
18 or
- 19 4. HUD determines that continuation of the property as rental housing would have an
20 undesirable and deleterious effect on the community.

21
22 The statutorily imposed prepayment restriction is not intended to prohibit refinancing under
23 Section 223(a)(7) though the terms of a GNMA or other mortgage backed security or bond
24 financing may restrict prepayment. A Section 223(f) Use Agreement is required for a refinancing
25 of an existing Section 207 insured loan pursuant to Section 223(f)/ 223(a)(7) if the mortgage is
26 aged less than five years from the Final Endorsement date.

27
28 J. Eligible Borrowers. Both for-profit and nonprofit Single Asset Mortgagor Entities are eligible to
29 apply. Tenants-in-common, Delaware Statutory Trusts, and natural persons are not eligible single
30 asset mortgagor entities but, can hold “upper-tier” ownership interests.

31
32 K. Maximum Loan Ratios and Debt Service Coverage Ratios. The following loan ratios and
33 percentages control the loan amount and are detailed on the Form HUD-92264-A, Supplement to
34 Project Analysis, mortgage criteria. The lowest of the mortgage criterion controls the loan
35 amount.

1 Section 223(f)

2 Refinance and Acquisition Processing

3 Criteria 1:

4 Loan Amount Requested on Application. The requested application amount may be amended
5 when appropriate.

6 Criteria 3:

7 Amount Based on Value: The applicable percentage of the estimated value of the property after
8 completion of repairs and improvements.

- 9 a. 90% - for Section 202 & 202/8 direct loans and for projects with 90% or greater
10 rental assistance
- 11 b. 87% - for projects that meet the definition of Affordable Housing and for which
12 the achievable Tax Credit rents are at least 10% below market rents; or
- 13 c. 85% - for market rate projects or Tax Credit projects without a significant rent
14 advantage (i.e. the achievable rents are at least 10% below market.)

15

16 Criteria 4:

17 Amount Based on Limitations per Family Unit: Where percentages are required, enter the same
18 percentage applied under Criteria 3. See Chapter 8 for complete details and the MF Housing
19 website: <http://www.hud.gov/offices/hsg/mfh/hicost/hicost.cfm> on information for per family
20 unit limitations and the High Cost Percentage by jurisdiction.

21 Criteria 5:

22 Amount Based on DCR (ratios are rounded for presentation purposes):

- 23 a. 90% of NOI (1.11 DCR) - for Section 202 & 202/8 direct loans and for projects
24 with 90% or greater rental assistance

1 b. 87% of NOI (1.15 DCR) - for projects that meet the definition of Affordable
2 Housing and for which the achievable Tax Credit rents are at least 10% below
3 market rents; or

4 c. 85% of NOI (1.176 DCR) - for market rate projects or Tax Credit projects
5 without a significant rent advantage (i.e. the achievable rents are at least 10%
6 below market.)

7 Acquisition Applications

8 Criteria 7:

9
10 Amount Based on Total Cost of Acquisition Section 223(f). The following percentages apply to
11 Line 7d. (i.e. formula to compute the loan closing charges) and Line 7h.:

12 a. 90% - for Section 202 & 202/8 direct loans and for projects with 90% or greater
13 rental assistance

14 b. 87% - for projects that meet the definition of Affordable Housing and for which
15 the achievable Tax Credit rents are at least 10% below market rents; or

16 c. 85% - for market rate projects or Tax Credit projects without a significant rent
17 advantage (i.e. the achievable rents are at least 10% below market.)

18 Criteria 10: The greater of 80% of LTV, or the Cost to Refinance.

19
20 L. Cash Out/Equity Out Proceeds. Fifty percent (50%) of any cash out proceeds after funding
21 mortgageable transaction costs and the assurance of completion requirements must be held in an
22 escrow by the lender until the required non-critical repairs are completed and HUD approves the
23 release. (See Chapter 8 for detailed escrow release instructions). Waivers to allow holding back
24 a lesser percentage of cash out proceeds will only be considered when the holdback is greater
25 than both \$1,000,000 and the assurance of completion escrow (20% of repair costs). The owner
26 must have demonstrated the ability to complete repairs in a timely manner, and a commitment to
27 keeping the property in good repair with no deferred maintenance.

28
29 M. Reserve for Replacements. An Initial Deposit and Annual Deposits must be made to the
30 Reserve for Replacements in accordance with the PCNA and underwriting conclusions.

31

1 N. Secondary Financing. HUD permits secured secondary financing on Section 223(f) loans up
2 to total debt of 92.5 Loan-to-Value, or as otherwise specified for affordable housing projects.
3 (See Chapter 8 and chapter 14 for details.)
4

5 O. Commercial Space. Commercial space is limited to 20% of total net rentable area and
6 commercial income to 20% of effective gross project income.
7

8 P. Real Estate Requirements. The mortgage must be on real estate held:

9 1. In fee simple; or

10 2. Under a leasehold estate approved by HUD with a minimum term of 50 years from the
11 date the mortgage is executed. Both the land and the improvements may be subject to the
12 leasehold, so long as OGC determines there is adequate security for the loan.
13

14 Q. Mortgage Term. The maximum term of the mortgage is 35 years or 75% of the remaining
15 economic life of the property, whichever is less, provided that the term may not be less than 10
16 years. (See Section 8.5 and 24 CFR 200.82)
17

18 R. Firm Commitment Processing Only. Lenders should participate in a concept meeting with the
19 Regional Center or Satellite Office prior to application submission if there are concerns about
20 marketability, environment, competing proposals or for particularly complex financing structures
21 or projects with significant cash out or large loans.
22

23 S. Physical Occupancy Standards. Section 223(f) has minimum and maximum physical
24 occupancy eligibility and underwriting requirements. See Section 7.6.A.7 for further details.
25

26 T. Market Study. Section 223(f) applications typically do not require a market study separate
27 from that contained in the appraisal. However, in volatile or declining markets, the lender should
28 consider and may be required to obtain a market study to support the underwriting conclusions of
29 market demand for the property over the loan term. Regional Center or Satellite Office staff
30 should consult with Economic Market Analysis Division (EMAD) in such cases. Requirements
31 for market studies are contained in Chapter 7.
32

33 U. Discounts and/or Costs of Issuance associated with bond financing may be eligible for
34 inclusion in the computation of Criteria 7 and 10.

1 1. Review documentation regarding permanent financing. Documentation must state the
2 amount of the discounts, financing fees, and/or costs of issuance to be charged and with
3 whom they will be paid.

4 2. Permanent Placement Fee. This fee must include all permanent placement expenses,
5 including lender's legal fees, except discounts. Where GNMA Mortgage-Backed
6 Securities (MBS) are involved and the mortgagee charges:

7 a. The maximum permanent placement fee, it may not assess an additional charge
8 for either the MBS application fee and/or the securities custodial fee.

9 b. Less than the maximum permanent placement fee, it may assess an additional
10 charge for either the MBS application fee and/or the securities custodial fee
11 provided the total fees and charges do not exceed the dollar value of the
12 maximum permitted permanent placement fee.

13 3. Determine if the discounts, financing fees and costs of issuance are reasonable and
14 generally in line with prevailing market conditions and mortgage credit data.

15 Recognize financing fees and discounts charged by the permanent lender, for inclusion in
16 the mortgage:

17 a. Bond fees included in the mortgage transaction:

18 (1) Where a project is to be financed through the sale of either taxable or
19 tax-exempt bonds, the maximum financing fees allowable in the mortgage
20 computation and recognizable for cost certification purposes is 5.5% of
21 the mortgage amount. Any cost beyond the 5.5% must be paid from
22 sources outside the mortgage.

23 (2) The maximum financing fee the mortgagee may retain for its own
24 account is 3.5% to cover the costs of origination, permanent placement,
25 processing, underwriting, closing and delivery (including the mortgagee's
26 legal fees), escrow monitoring, etc. The remaining 2% (or such greater
27 percentage as may result from the lender reducing its maximum retained
28 3.5% fee) may be used to offset the bond fees.

29 b. Discounts. In a refinancing or purchase transaction, discount fees will be
30 recognized only for those actual costs charged by the placement lender, which are
31 determined to be eligible. Discounts included in the computation of Criteria 7 and
32 10 must be reasonable based on current market conditions.

33
34 V. Defeasance costs associated with underlying bond financing, yield maintenance, swap
35 termination fees, or costs to satisfy similar derivative instruments are not eligible cost basis fan

1 may only be paid out of multifamily FHA insured mortgage proceeds when the loan amount is
2 less than or equal to 80% LTV.

3.8 Section 223(a)(7) Refinancing of Existing Insured Mortgages

5
6 The Section 223(a)(7) program is more fully described in Chapter 18 of this Guide. The program
7 was included as a MAP Program in July 2010, and provides for streamlined refinancing of
8 currently insured FHA loans. Accordingly, some requirements of MAP processing for other
9 multifamily programs are not required. The following is a summary of the program features:

10 Eligibility: Only currently FHA insured loans are eligible. HUD held loans are not eligible
11 unless subject to a Mark-to-Market Debt Restructuring under MAHRAA. Risk
12 Share loans are not eligible (by statute). Properties which need substantial repairs or
13 propose new construction (e.g. of additional units or other permanent structures) are
14 not eligible.

15 Terms: Most transactions are processed with a lower interest rate, and re-amortized either
16 within the remaining term or with an extension up to 12 years. Exceptions are
17 detailed in chapter 18. Extended amortizations may reduce risk to the Department
18 by lowering debt service requirements so long as the PCNA evidences the physical
19 condition supports the extended term of the mortgage. In every case, the loan term
20 cannot exceed 75% of the remaining useful life of the property.

21 Controlling Mortgage Criteria: The loan is limited to the lesser of the original principal balance,
22 the existing indebtedness plus transaction costs, and that which can be supported by
23 90% of NOI (95% for projects with greater than 90% Project-Based Rental
24 Assistance).

25 Lender Fees: Chapter 18 provides more detail. The one exception to the prohibition on
26 inducements is the payment of pre-payment penalties on an existing FHA insured
27 loan from lender's trade profit (also known as marketing gain or premium on the
28 sale of a Ginnie Mae security). The lender may pay such pre-payment penalties on
29 behalf of the borrower, so long as disclosed to and approved in advance by HUD.

1 Pre-payment penalties payable by lenders do not include the cost of defeasance or
2 penalties associate with bond financing, or defeasance of other mortgage-backed
3 securities (including Ginnie Mae securities).

4 Borrower Fees: Lenders cannot pay application or due diligence fees on behalf of the borrower,
5 or other payments as an inducement. To do so would be considered a kick-back,
6 and a basis for Enforcement action. This broad prohibition applies to affiliates of
7 either the lender or the borrower, and includes any payment or contribution from
8 the lender directly to the borrower or in support of their interests. Other than to pay
9 for PCNA costs, existing Reserve for Replacement deposits (for HUD held or FHA
10 insured mortgages) are not available for application fees or other transaction costs.

11 PCNA: A complete PCNA is required, including intrusive testing for older
12 properties. The format, content, and scope of a required PCNA will not be waived.
13 Given properties applying for Section 223(a)(7) are already FHA insured, HUD
14 will, in evaluating the PCNA, exercise greater flexibility in sizing the reserves for
15 replacement requirements and timing of repairs, so long as the physical and
16 financial integrity of the project is ensured, and the owner and management agent
17 are in good standing.

18 Assuming the project has acceptable REAC scores and HUD Asset Management
19 staff concurs, HUD will consider waivers for projects which completed construction
20 or a substantial rehabilitation, or had a PCNA done within the last 5 years. In such,
21 cases, a PCNA will be required sooner than the normal schedule of every 10 years.

22 Other Issues: Projects in which the repairs or rehabilitation is extensive enough to require an
23 Environmental Assessment or compliance with Davis Bacon Wages, are not eligible
24 for Section 223(a)(7) refinancing.

25 An officer of the lender who is an approved signator must sign the application. Site
26 visits and an approved MAP underwriter is generally not required, though the
27 physical condition or other issues in specific transactions may require such a site
28 visit and underwriter review.

1 Prepayment approval must be requested by the servicing mortgagee at the time of
2 the application. When the refinancing is being performed by a different firm than
3 currently services the loan, a letter accompanying the Firm Commitment application
4 and signed by the borrower to the Servicing lender notifying them of their intent to
5 refinance and requesting their filing of the HUD form 9807 will be accepted in lieu
6 of the actual request for prepayment approval.

7 **3.9 Property Insurance Requirements**

8 A. Insurance During Construction.

9 1. Public Liability Insurance on a Commercial General Liability form with limits of not
10 less than \$500,000 per occurrence to protect the mortgagor during the construction phase
11 from claims involving bodily injury and/or death and damage to the property of others.
12 Such Commercial General Liability Insurance must be endorsed to include owners' and
13 contractors' protective coverage.

14 2. Vehicle Liability Insurance with limits of not less than \$300,000 for one person and
15 \$500,000 for more than one person to protect the mortgagor for claims for bodily injury
16 and/or death, and not less than \$100,000 against claims for damage to property of others
17 arising from the owner's operation of vehicles. Such insurance must include coverage for
18 employer's owned, non-owned and/or hired vehicles, where applicable.

19 B. Permanent Insurance. Upon acceptance of the project, or any portion thereof from the
20 contractor, the lender must provide a certified duplicate copy of the following insurance
21 coverage. In some instances, continuation of the insurance obtained for the construction period,
22 with proper endorsements thereto, will be acceptable. In any event, the lender must assure that
23 there is no gap period in insurance protection during the transition from the Insurance During
24 Construction to the Permanent Insurance.

25 1. Public Liability Insurance on a Commercial General Liability form with limits of not
26 less than \$500,000 per occurrence to protect the mortgagee from claims involving bodily
27 injury and/or death and property damage which may arise from the mortgagee's
28 operations, including any use or occupancy of its facilities, grounds and structures, and
29 must include independent contractors coverage, where applicable.

30 2. Vehicle Liability Insurance. If the mortgagee owns a vehicle in the operation of the
31 project, including non-owned and/or hired vehicles operated for the benefit of the
32 mortgagee, the mortgagee must maintain Vehicle Liability Insurance. Such insurance
33 must provide for limits of liability of not less than \$300,000 for one person and \$500,000
34 for more than one person to protect the mortgagee from claims for bodily injury and/or
35 death, and not less than \$100,000 against claims for damage to property of others.

1 C. Other Insurance Requirements. Both HUD and the lender must be named as additional insured
 2 on the policies of insurance. All insurance carriers or providers which issue policies of insurance
 3 on a HUD insured project must have and must maintain during the policy period a rating that is
 4 acceptable to HUD. The amount of property insurance required is discussed in Chapter 6 of this
 5 Guide and in the Asset management Handbook.
 6

7 **3.10 Large Loan Risk Mitigation Policies**

8 A. **Purpose**

9
 10 This section defines the underwriting standards for large multifamily loans, primarily those
 11 above \$75 million. Except where otherwise stated, these policies do not apply to:

- 12 a) loans below \$75 million,
- 13 b) refinancing loans processed under Section 223(a)(7),
- 14 c) refinancing or substantial rehabilitation loans for properties with rental assistance
 15 contracts covering 90% or more of the property’s units, or Low Income Housing Tax
 16 Credits with actual rents at least 10% below market, or
- 17 d) the insurance programs administered by the Office of Healthcare Programs.

18
 19 B. **Underwriting and Reserve Standards for Large Loans**

20
 21 1. The following DSCR, LTVR and LTCR underwriting standards shall be applied
 22 incrementally as loan sizes increase:

23
 24 New Construction/Sub Rehab under Sections 220, 221 (d)(4), 231, 241(a) on loans at or above
 25 \$75M:

26

27 Loan size	Affordable DSC limits	Affordable LTC limits	Market DSC limits	Market LTC limits
28 <\$75M	1.15	87%	1.176	85%
29 >\$75M *	1.25*	80%*	1.30*	75%*
30 *Represents current underwriting guidance.				

31
32
33

34
 35
 36
 37
 38 Refinancing under Section 223(f) on loans at or above \$75M:
 39

Loan size	Affordable DSC limits	Affordable LTV limits without/with cash out	Market DSC limits	Market LTV limits without/with cash out
<\$75M	1.176	87%/80%	1.20	85%/80%
>\$75M*	1.25*	80%*/70%*	1.30*	75%*/70%*

+*Represents current underwriting guidance.

Projects with greater than 90% Project-based rental assistance may be underwritten at up to 90% Loan Ratio, or 1.11 Debt Service Coverage for all programs, so long as the loans amount is less than \$75 million.

2. Minimum Initial Operating Deficit (IOD) and Debt Service Reserves for Large Loans

New construction/substantial rehabilitation projects with both a loan amount at or above \$25M should have a minimum amount of Initial Operating Deficit Reserve to help assure success of these projects during their early, most vulnerable stages of rent-up.

A minimum Debt Service Reserve is required for Large Loan Section 223(f) transaction which do not have at least 3 years of demonstrated stable occupancy and operations as well.

The following minimum Reserve amounts apply to Sections 220, 221 (d) (4) and 231 Loans (as IOD's) and Section 223(f) Loans (as Debt Service Reserves). If the amount determined under Section 7.14 of the MAP Guide "Calculating Operating Deficits" exceeds the amount shown below, the MAP Guide amount takes precedence.

Loan size	<i>Reserve amount based on minimum number of months of amortizing debt service, including MIP</i>
<\$25M	Between 4 to 6 months debt service
\$25M - \$75M	9 months debt service
>\$75M	12 months debt service
>\$100M	12 months debt service, unless a higher amount is identified through HUD analysis of the risks and the mitigants appropriate to the particular loan application
	Note: for projects \$25M or more which will complete rent-up within 12 months of construction completion, the stated minimum number of months of debt service may be reduced by 3 months.

1 3. Loans greater than \$100 million.

2 Based on HUD's analysis of the risks and the mitigants appropriate to the particular loan
3 application, the required minimum DSCR, LTCR *or* LTVRs, and the minimum Initial Operating
4 Deficit or Debt Service reserve requirements for loans over \$100M may be increased. Lenders
5 should detail appropriate risk mitigants for such transactions, which will be reviewed on a case-by-
6 case basis.

7
8 4. Eighteen (18) month Maximum Absorption Period

9
10 The absorption period for estimating market demand is limited to 18 months. Regional Office
11 Directors may waive the 18-month absorption period restriction only in cases where there is an
12 unusually strong market which will support initial rent-up to sustaining occupancy beyond 18
13 months and where the borrower has clearly demonstrated successful experience with developing
14 such projects in the recent past. Such projects may require larger Initial Operating Deficit or Debt
15 Service Reserves.

16
17 5. Other Underwriting Requirements for Large Loans

18
19 The following underwriting and mortgage credit requirements will apply to Large Loans:

20
21 i. Principal's net worth and liquidity requirements for loans greater than \$75
22 million:

23 Principals of the borrowing entity must have, in aggregate, net worth equal to at least
24 20% of the loan amount and liquidity equal to at least 7.5% of the loan amount. This
25 requirement may be waived for sponsors of subsidized affordable housing
26 properties.

27
28 ii. Recognition of land or building value appreciation for loans greater than \$25
29 million:

30 For properties refinanced under Section 223(f), or for land or buildings contributed
31 for development under Sections 220, 221 (d) (4) and 231, the HUD review appraiser
32 may not recognize an increase in the appraised value above the borrower's
33 acquisition cost plus the direct costs incurred for property improvements, unless the
34 borrower has owned the property for 3 years or longer as of the date of application.

35
36 For properties owned for less than 3 years as of the date of application, the
37 recognized value of the property will be the lower of: a) the appraised value, or b)
38 the property acquisition cost plus direct costs incurred by the borrower for
39 improvements to enhance or upgrade the property, such as to rehabilitate or upgrade
40 an existing building, to obtain a zoning change, or for improvements to land such as

1 removal of environmental hazards or improvements to infrastructure, which costs
2 and improvements must be documented by the borrower and verified by the lender.

3
4 For properties owned for less than 3 years as of the date of application, the Regional
5 Center Director may issue a waiver to permit recognition of an increase in the
6 appraised value above the property acquisition cost plus the cost of improvements,
7 only if both of the following criteria are met:

- 8
9 a) The values of comparable properties located in the subject's submarket have
10 also increased since the date of acquisition, and
11
12 b) The value increase is based on an increase in property NOI due to improved
13 property operations and is not based solely on recognition of a capitalization
14 rate that is lower than what was prevalent in the market or was applied by the
15 sponsor at the time the property was acquired.

- 16
17 iii. Experience requirements for large new construction or substantial rehabilitation
18 projects with loans greater than \$25 million.

19 Large Loan borrowers must have substantial prior experience developing,
20 constructing and owning multifamily projects that are similar in size and scope to
21 what is proposed. Borrowers or contractors without substantial prior experience in
22 multifamily construction, lease up and property operations, and who have not
23 previously successfully owned or developed other large multifamily projects, will
24 not qualify for a Large Loan under any of the Multifamily New Construction or
25 Substantial Rehabilitation programs. Borrowers with no experience operating
26 multifamily rental housing will not be considered for acquisition financing under
27 Section 223(f) unless there are significant mitigants (e.g. the principals have clean
28 credit, strong diversified financial capacity, and the property will be managed by a
29 third party management agent with relevant and positive HUD experience,
30 conservative valuation.)

31
32 Related experience in single family development or in development of commercial
33 properties is not an acceptable substitute for the required prior multifamily
34 experience and may not be a basis for a waiver of the experience requirement.

Chapter 4 Application Processing

4.1 Introduction / General

Only an approved MAP Lender and MAP-approved Underwriter may submit an application for insurance using MAP. Lenders should contact the MF Regional Center's Workload Distribution Lead to discuss the submission of an application for insurance using MAP.

Approval of Lender's Reviewers. The lender is responsible for assigning a MAP-approved Underwriter, who is responsible for selection and management of their third party consultants. If a Regional Center or Satellite Office has concerns about an underwriter or a proposed third party consultant, they should contact the Asset Management and Counterparty Oversight Division before responding to the lender.

The lender must identify the Construction Loan Administrator prior to the Firm Commitment stage.

4.2 Stages of Application

A. Refinancing Applications (Sections 223(f), 223(a)(7))

1. Concept meetings (or conference calls) with the MF Regional Center or Satellite Office are optional and generally not needed for refinancing transactions. They are recommended for projects in volatile markets, large loan requests, questions about the scope of repairs, significant cash out, if there are concerns about marketability, environment, competing proposals, for projects with significant cash out, large loans, or if there are other unusual risk factors. Upon the lender's request, the MAP Coordinator will schedule the meeting either in person or by teleconference as soon as workload permits. Site visits by the appropriate HUD staff may be conducted if practicable. Please refer to Appendix 4 for concept meeting exhibits.

- 1 HUD will respond by written letter or by email within 5 business days of the concept
2 meeting. Consideration will be given as to the effect on other insured projects in the
3 subject's market area that are already in the pipeline or in portfolio, developer
4 experience and overall feasibility based on the exhibits and information presented.
5 Depending on the completeness and quality of the submission, HUD may recommend
6 that the lender submit an application, request additional information, or specify
7 conditions or recommendations to consider. The written response to the concept
8 meeting does not represent a commitment from HUD nor that a letter of invitation
9 will be issued, and this should be clearly stated in the response.
- 10 2. Firm Commitment application submissions will be reviewed for completeness,
11 processed, reviewed and underwritten and either recommended for approval or
12 approval with conditions, returned to the lender for modifications, or rejected.
- 13 3. Loan Approval is either by National Loan Committee, Regional Center/Satellite
14 Office Loan Committee, or Regional Director signature authority. Loan Committee
15 requirements are specified in Appendix 4A.
- 16 4. Firm Commitment issuance.
- 17 5. Firm Commitment acceptance and rate lock. Firm Commitments may be extended up
18 to no more than 180 days from date of insurance. After that time, a reopening fee of
19 50 basis points is required.
- 20 6. Closing.
- 21
- 22 B. New Construction and Substantial Rehabilitation Programs
- 23 1. Concept meetings (or conference calls) with the MF Regional Center or Satellite
24 Office are required for market rate new construction or substantial rehabilitation
25 transactions (unless waived by the Regional Director) and optional for affordable
26 transactions. The process for concept meetings is the same as for refinancing
27 transactions. Lenders may submit applications for market rate deals without a concept
28 meeting; however the application fee will be considered "earned" at acceptance of the
29 application for processing and will not be refunded if the application is rejected or not
30 approved under terms acceptable to the lender and borrower.

- 1 The lender may request to skip the Pre-application stage to go directly to Firm
2 Commitment application. Lenders should only consider such requests for projects in
3 strong markets, where the lender and borrower acknowledge in writing the risk of a
4 rejection and that the application fee is nonrefundable, so long as there are no
5 environmental issues, and the lender, borrower, and development team members have
6 previous positive experience with FHA Multifamily financing.
- 7 2. The Pre-application stage for new construction or substantial rehabilitation is
8 designed to permit HUD to review the feasibility of a proposed project prior to the
9 lender, borrower, and HUD spending the time and expense involved in Firm
10 Commitment processing. Pre-application submissions will be reviewed for
11 completeness, processed, reviewed and underwritten, and either recommended to be
12 approved, approved with conditions, returned to the lender for modifications, or
13 rejected.
- 14
- 15 If an invitation letter is issued, the lender must advise HUD in writing within 30
16 calendar days if it plans to submit a Firm Commitment application. If it fails to notify
17 HUD, the invitation letter will expire and the lender will be required to repeat the Pre-
18 application process. Letters of invitation are issued and effective for 120 calendar
19 days.
- 20 The application for a Firm Commitment must be submitted within 120 days of the
21 date of the letter of invitation. The Regional Director may or may not authorize one
22 extension up to 90 days. The HUD Underwriter will review the lender's extension
23 request.
- 24 If there is a justifiable request by the lender for an extension of time beyond the time
25 period allowed (210 total days), the Regional Director must request approval for a
26 further extension from the Director of the Office of Multifamily Production, in HQ
27 stating the additional time requested, the Regional Director's recommendation and
28 the reasons for the extension.
- 29 3. Loan Approval is either by National Loan Committee, Regional Center Loan
30 Committee, or Regional Director signature authority. Loan Committee requirements
31 are specified in Appendix 4B.
- 32 4. The Firm Commitment through rate lock stage for new construction and substantial
33 rehabilitation are the same as for refinancing transactions.
- 34 5. A pre-construction conference is required prior to Initial Endorsement / Closing.

- 1 6. Closing.
- 2 7. Construction period.
- 3 8. Cost Certification.
- 4 9. Final Endorsement.

5 C. Appeals

6 Lenders have the right to appeal HUD decisions regarding the issuance of an Invitation for
7 Firm Application or Firm Commitment with which they do not agree. There is no appeal
8 process for the concept meeting recommendation. Other parties (borrowers, third parties) do
9 not have a formal right to appeal. Appeals must be filed in writing, delivered electronically
10 and by hard copy, to the Regional Director. The appeal must explicitly address the basis for
11 the appeal and disagreement, and include supporting documentation and background
12 information, including a copy of relevant previous correspondence and reports.

13 The Regional Director will assign the appeal for review to staff not involved in the original
14 decision. The Regional Director will issue a written response to the Lender within 30 days of
15 receipt of the appeal, or such other period of time as practicable. If the original decision
16 being appealed was a result of a Regional Center Loan Committee which the Regional
17 Director participated in, the Regional Director will either hear the appeal or may request it be
18 treated as a second level appeal and referred to HUD Headquarters.

19 If the lender is not satisfied with the appeal decision, they have the right to a second level
20 appeal, which should be addressed to the Director of Production in HUD Headquarters. The
21 Director will assign the appeal for review to technical support or other staff not involved in
22 the original decision. The Director will issue a written response to the Lender within 30 days
23 of receipt of the appeal, or such other period of time as practicable.

24

25 **4.3 Lender Processing**

26

27 A. General Requirements

- 28 1. Borrower engagement letters are expected as a prudent business practice, but not regulated by
29 HUD. Only one MAP lender may be engaged at a time. If a borrower changes MAP lenders
30 prior to or after submission of an application, the borrower must disclose the processing

1 history, and the MAP Lender submitting the application must address it in the Underwriter
2 Narrative Executive Summary.

3 2. Lenders must use third party Engagement letters. HUD recommends extension clauses.

4 3. Electronic submission of applications material, Standard Underwriting Narrative, and data
5 through the electronic “wheelbarrow” is required. Application checklists are in Appendix 4.
6 HUD will in the future continue moving to complete electronic submission and processing
7 through a web-based portal.

8 4. MAP Lenders are required to comply with the procedures and management controls specified
9 in their Quality Control Plans.

10 5. Pre-Approval of Principals with Large Concentrations of FHA Insured Debt. The
11 lender must perform a thorough mortgage credit and creditworthiness review, and obtain
12 HUD approval, before submission of an application in cases where principals have greater
13 than \$250,000,000 of outstanding FHA insured debt. Please refer to Section 8.8 for
14 additional information.

15 6. Lenders may produce their own copies of HUD forms, so long as the recreated forms
16 have the correct Office Management and Budget (OMB) numbers, HUD form
17 numbers, expiration dates, form titles, and are identical in content and order of the line
18 items on the MAP Form. All forms must be completed subject to their respective
19 instructions. (See HUDClips)

20 7. A complete application submission includes one original, one additional hard copy and
21 one electronic copy. The additional hard copy should be in a separately bound
22 mortgage credit file, and the rest of the application containing the exhibits which do
23 not contain sensitive personal and Privacy Act protected information. A standardized
24 underwriting narrative and more structured application checklist are now required as
25 well.

26
27 B. Processing

28 The lender’s MAP approved Underwriter is responsible for oversight and performance of the
29 following tasks:

30 1. Data collection;

31 2. Due diligence;

32 3. Loan Processing;

- 1 4. Mortgage Credit review;
- 2 5. Underwriting;
- 3 6. Obtain internal loan approval (from the lender's loan committee or other process);
- 4 7. Submission of the loan application and fee to the appropriate Regional Center or
- 5 Satellite Office;
- 6 8. Responding to HUD deficiency letters and requests for information;
- 7 9. Follow-up to get the loan to closing;
- 8 10. Coordination with construction loan administration, cost certification, and servicing.

9 **4.4 HUD Processing**

10 A. General Requirements

- 11 1. Under the direction of the MF Regional Director, the HUD Underwriter is responsible
- 12 for management of the application processing, review, underwriting, loan approval
- 13 and closing processes, as well as coordination of turn over to Asset Management at
- 14 closing.
- 15 2. HUD review is a risk based, underwriting approach. Technical compliance and
- 16 processing must be correct and documented, but the primary purpose of HUD's
- 17 review is to determine if the loan application is an acceptable risk to the FHA
- 18 insurance fund.
- 19 3. Standard Processing Times are detailed in Appendix 1.
- 20 4. The HUD Underwriter will reviews all application exhibits and determine what
- 21 technical reviews are necessary, if any, given the level of complexity and risk of the
- 22 transaction and program type, and perform or arrange for the underwriting and
- 23 mortgage credit analysis.

24 Risk-based processing and the single underwriter model will allow qualified underwriters to
25 review architectural/cost exhibits, appraisals, and market analyses, and solicit the assistance of
26 appropriate HUD technical specialists to perform additional reviews as necessary depending on
27 the level of risk and complexity of each individual transaction. A Construction Analyst may be
28 called upon to advise the underwriter in his or her review, or to perform a limited review or full
29 review, as determined by the Production team. The level of review by the HUD Construction
30 Analyst may vary but, the work required from the lender's third party provider has not changed.
31 The MAP Lender and third party provider are responsible for determining the acceptability of the
32 physical improvements, providing conclusions essential for underwriting determinations to

1 minimize mortgage risk, and ensuring compliance with MAP Guide instructions and guidance.
2 Similarly, the HUD Appraiser may be called upon to act in an advisory role or perform limited or
3 full reviews as deemed appropriate by the HUD Production team.

- 4 5. HUD has certain responsibilities which it does not assign to the lender, including
5 responsibility for the environmental clearance, approval of the owner's Affirmative Fair
6 Housing Marketing program, Previous Participation review, and issuing the commitment
7 for mortgage insurance.
- 8 6. HUD staff must perform a site visit for all applications in which an Environmental
9 Assessment is required. Environmental approval is documented by HUD on the Form
10 HUD-4128. The lender and the third party consultants prepare information for HUD's
11 review and assistance in completing the review. The form HUD-4128 must be signed by
12 the Regional Director or other delegated authority as part of the Firm Commitment
13 approval. The site visit is typically performed by a HUD Appraiser, Construction Loan
14 Analyst, Senior Underwriter, or other experienced HUD staff or managers with training
15 and experience in environmental review requirements after review of the third party and
16 lender's environmental analysis. HUD Regional and Headquarters Environmental
17 Officers may be called on to assist if and as questions arise.
- 18 7. Applications which the Regional Center or Satellite Office determine to be
19 unacceptable will be returned to the lender and HUD will retain the application fee if
20 the transaction completed screening and was put into underwriting and technical
21 review. If it is clear at the screening stage the transaction is not approvable, it will be
22 rejected at that stage. Lenders repeatedly submitting premature, materially deficient,
23 or otherwise unacceptable applications should be referred to the Asset Management
24 and Counterparty Oversight Division.
- 25 8. Review of MAP Lender Team Members. HUD must check the Limited Denial of
26 Participation List and the Consolidated List of Suspended and Debarred Contractors
27 for all proposed lender team members, and review the proposed MAP Lender and
28 underwriter, and third party resumes. If there is a concern with past performance, the
29 Regional Director will consult with Asset Management and Counterparty Oversight
30 Division for guidance on how to proceed. If appropriate, adverse findings or
31 conclusions should be communicated to the lender within 10 business days.

32 33 B. Processing

34 Under the direction of the MF Regional Director, Production Division Director, and
35 Underwriter Branch Chief, the HUD Underwriter is responsible for the oversight and
36 performance of the following tasks:

- 37 1. Concept meetings and follow-up communication;

- 1 2. Reviewing of proposed MAP Lender and Underwriters;
- 2 3. Working with the Workload Distribution Lead for the Region and other appropriate
- 3 officials in managing workload assignments for new applications;
- 4 4. Acknowledging receipt of the application;
- 5 5. Ensuring the screening of applications for completeness, and fiscal controls for new
- 6 application submissions;
- 7 6. Using the New Early Warning System (NEWS) to determine what level of
- 8 underwriter and technical specialist review is required given the complexity and risk
- 9 factors associated the transaction;
- 10 6. If during underwriting and technical review, HUD staff determines the application to
- 11 be deficient, advising the lender who will have 5 business days to correct the defects
- 12 or deficiencies. If the defects/deficiencies cannot be corrected within the 5 business
- 13 days, or such other time frame as the Regional Director deems appropriate, HUD will
- 14 preliminarily reject the application and stop processing;
- 15 7. Performing technical reviews of lender underwriting and third party reports, or
- 16 arranging for HUD technical specialist reviews for higher risk or more complex
- 17 transactions when needed;;
- 18 9. Consulting with and obtaining reviews from Asset Management, Legal, Labor
- 19 Relations, EMAD, FHEO, and other HUD staff as appropriate depending on the
- 20 program requirements and particular transaction features; Recommending
- 21 transactions for loan approval (or rejection);
- 22 8. Preparing and issuing Pre-application Invitation letters and Firm Commitments;
- 23 9. Coordinating the closing process with the Closing Coordinators, OGC, the lender, and
- 24 borrower's team;
- 25 10. Coordinating with Asset Management in turnover of files, briefing about conditions
- 26 of the Firm Commitment, and providing information necessary for Asset
- 27 Management's risk rating of the transaction.
- 28 C. Construction Period Responsibilities
- 29 5. Under MAP, HUD must approve the initial and final draws.

- 1 6. HUD will perform or contract or otherwise provide for inspection duties and will
2 provide copies of the Trip Report to the MAP Lender.
- 3 7. The MAP Lender will prepare and approve the documents required for the interim
4 draws during construction.
- 5 8. HUD must approve the construction amount for each item in the initial and final
6 advance and for each Change Order during construction.

7 D. Servicing

8 MAP makes no changes in procedures for servicing or asset management, except for
9 servicing lenders with prior approval for delegated responsibility for repair escrow
10 administration. See Section 1.2 above for guidance on MAP-approved lenders who only
11 originate loans and transfers the loan to another FHA-approved lender for servicing.

DRAFT

Chapter 5 Architectural & Construction Analysis

5.1 Qualifications, Responsibilities, and Approval of Lender's Representative

A. Scope of Work and Qualifications

1. Scope of Work for Construction Analysts and Needs Assessors

- a. Construction Analyst. The Lender must hire a qualified construction analyst(s) with experience in multifamily construction. The analyst must be knowledgeable and experienced with local building standards and construction methods, relevant national or international building codes and standards (e.g., International Existing Building Code, International Energy Conservation Code) and specific statutory or regulatory requirements for multifamily housing (e.g., Federal Fair Housing Accessibility Guidelines and the Uniform Federal Accessibility Standards, UFAS). The construction analyst(s) must:
 - i. Review and evaluate architectural design, specification, construction contract, and cost and scheduling documents for proposed projects and assure internal consistency, accuracy, reasonableness, and conformance to HUD requirements;
 - ii. evaluate the design of existing buildings and the construction materials, methods or technologies employed in existing buildings;
 - iii. review and confirm the reasonableness and validity of any due diligence conducted concerning physical attributes of sites, buildings or properties and identify an unmet need for such due diligence;
 - iv. review and confirm the reasonableness of costs for design, specification, construction, contract administration and supervision (and any related due diligence or other professional services) for the construction, alteration or repair of multifamily structures; and.
 - v. evaluate the professional qualifications and experience of the borrower's design and construction team members and any due

1 diligence professionals or contractors retained by the borrower or the
2 lender to assure conformance to HUD requirements and suitability for
3 the anticipated scope work.

4 NOTE: Construction analyst(s) must apply the specific standards or criteria
5 enumerated in the Appendices to this Chapter 5. The construction analyst is not
6 required to review structural design details and calculations.

7 b. Needs Assessor. See Appendix 5G Section III for a description of who must
8 prepare a capital needs assessment (CNA) by program and/or class of work, as
9 well as the needs assessor's responsibilities and qualifications.

10 c. Energy Auditors. See Appendix 5G Section IV, subsection G for a description of
11 qualifications and experience for energy auditors.

12 2. Specific Qualifications of Lender's Construction Analysts and Technical Specialists

13 a. Construction Analyst(s):

14 The person providing construction analysis services should preferably be a
15 registered architect or physical engineer but must, at a minimum, have a
16 degree (BS) in architecture or civil or structural engineering or construction
17 with five years of experience in design, construction, or development of
18 multifamily buildings. Alternatively any person who is a construction contract
19 administrator with a current certification (CCCA) by the Construction
20 Specifications Institute (CSI) and who has administered construction of not
21 less than three multifamily properties with an aggregate construction cost not
22 less than \$30 million may serve as a construction analyst. In all cases the
23 lender must assure that the work experience of the construction analyst is
24 consistent with the scale, scope, materials, methods and technologies proposed
25 for or existing at the property.

26 b. Other Technical Specialists:

27 Technical specialists such as mechanical, structural, sanitary, or civil
28 engineers, may be required for review of a particular project. The principal of
29 the technical specialists' firm must be a licensed professional, must sign any
30 resulting report or opinion and when applicable must affix his/her professional
31 seal.

32 3. HUD Approval of Qualifications

33 The lender must disclose the qualifications of its construction analyst(s) or other
34 technical specialists. HUD reserves the right to examine credentials and experience
35 and to reject individuals it deems unqualified for a particular assignment.

1 B. Duties and Responsibilities

2 The Lender's construction analyst:

- 3 1. Visits the site and its environs and invests time and attention to detail sufficient to
4 provide a knowledgeable and professional review and analysis of due diligence
5 requirements and needed investigations, as well as of design, specification and
6 construction documents to be prepared.
- 7 2. Reviews borrower's required architectural services. (See Section 5.3)
- 8 3. Maintains a dated log of all contacts, messages and conversations with the architect
9 and the borrowers design team, if any, and any engaged due diligence professionals
10 including the needs assessor and energy auditor, referencing all documents and
11 versions thereof in the log.
- 12 4. Assures that all relevant parties are informed of HUD requirements and
13 communications and coordinates responses thereto.
- 14 5. Determines that the existing or proposed project design complies with the Minimum
15 Property Standards, local codes, the applicable accessibility requirements and HUD design
16 standards (See Appendix 5).
- 17 6. Determines that the borrower's Design Professional (or other persons or organizations
18 providing architectural or due diligence services) is qualified to provide required
19 services to the project and when applicable, to administer the construction contract.
- 20 7. Reviews borrower's Architect's certification that the project design complies with the
21 Minimum Property Standards, all applicable local codes and ordinances, accessibility
22 requirements, and HUD standards (See Appendix 5).
- 23 8. Determines that the professional liability and errors and omissions insurance for the
24 Architect and other design or due diligence professionals is sufficient in light of the
25 scale and cost of construction and/or evident risks due to physical conditions, and that
26 such insurance will be maintained through any warranty inspection period following
27 Final Endorsement.
- 28 9. Prepares a complete cost analysis for any proposed construction, alterations, or
29 immediate repairs. For existing properties, determines that proposed repairs and
30 alterations are both appropriate and sufficient based upon the condition of the
31 property. This review specifically includes the identification and correction of any
32 accessibility deficiencies.
- 33 10. Determines that due diligence concerning physical attributes of the site or of existing
34 buildings is sufficient to expose and quantify such costs and risks as may be

- 1 reasonably expected based on observed conditions and identifies any unmet due
2 diligence needs.
- 3 11. Prepares or reviews the schedule of anticipated future capital needs and
4 corresponding estimates of costs.
- 5 12. Reviews and confirms as part of the CNA the accuracy of estimates of replacement
6 cost (new) for each structure (HUD 92329).
- 7 13. Identifies, reviews and describes to HUD any identities of interest among any
8 members of the design, construction and/or due diligence team or between any such
9 member and any principal of the borrower or between any such member and the
10 lender; and
- 11 14. Provides advice and assistance on design, construction and physical due diligence
12 issues to borrowers, consultants, contractors and others.

14 5.2 Classification of Work and Eligible Construction 15 Activities

16
17 Eligible construction activities are described in terms of costs and scope for two purposes. The
18 first purpose is to determine eligibility of the construction activity by program, i.e., by Section
19 of the National Housing Act. The second is to identify what design documentation,
20 construction supervision and management, and work inspection methods are most appropriate
21 to the proposed work.

22 23 A. Classification of Work

24 Classification of work is an important aspect of scope. Construction activity is either
25 new construction (erecting buildings not previously in existence) or some level of work
26 on existing structure(s). The class of work with the largest scope is “new construction.”
27 The International Building Code for Existing Structure (2012, Chapter 5) defines
28 additional classes of work on existing structures. In order by scope from least to greatest
29 and with certain *italicized* amendments, these classes of work are:

- 30 1. Repair: “The restoration to good or sound condition of any part of an existing
31 building for the purpose of its maintenance.” (IBC, Section 202) *Repairs to site*
32 *features (not buildings) but otherwise similarly defined are included in this class of*
33 *work.* “Repairs include the patching or restoration or replacement of damaged
34 materials, elements, equipment or fixtures for the purpose of maintaining such
35 existing components in good or sound condition with respect to existing loads or
36 performance requirements.” (IBC, Section 502) Repairs also include related work.

1 Related work is “work on non-damaged components necessary to accomplish the
2 required repair of damaged or deficient components.” (IBC Section 502.3) *In*
3 *addition, installation of items not previously present in a building or on a site but*
4 *necessary to address safety, security, accessibility or communications needs are*
5 *considered repairs when such installation and related work does not require*
6 *alterations. Examples of such installation include but are not limited to smoke*
7 *detectors added to bedrooms, signage or pavement markings added to identify*
8 *accessible paths, panic bars added to exit doors, etc.*

- 9 2. Level 1 Alterations: “The removal and replacement or the covering of existing
10 materials, elements, equipment, or fixtures using new materials, elements, equipment,
11 or fixtures that serve the same purpose.” (IBC Section 503.1)
- 12 3. Level 2 Alterations: “The reconfiguration of space, the addition or elimination of any
13 [*exterior*] door or window, the reconfiguration or extension of any system, or the
14 installation of any additional equipment. (IBC Section 504.1)
- 15 4. Level 3 Alterations: “Alterations where the work area [*consisting of all reconfigured*
16 *spaces*] exceeds 50% of the aggregate area of the building.” (IBC Section 505.1)

17 18 B. Building Systems

19
20 Program eligibility for a scope of work may also be determined by the replacement of
21 building systems.

- 22
23 1 For purposes of determining program eligibility, there are five building systems:
- 24 a. Structural frame, including foundations, load bearing walls, floor frame, and
25 roof frame;
 - 26 b. Building envelope, including exterior moisture and weather proof membranes,
27 roofing, cladding, siding, windows and exterior doors and openings;
 - 28 c. Mechanical, including heating, ventilating and air conditioning equipment and
29 related fuel supply or exhaust items, as well as specialized mechanical
30 apparatus such as elevators and escalators;
 - 31 d. Electrical, including all electrical appliances (not mechanical) and lighting
32 fixtures, electrical supply lines and panels, breakers, warning systems, and
33 telecommunications and related equipment.

1 e. Plumbing, including all potable water, grey water, and sanitary waste lines,
2 valves, pumps, controls, and fixtures.

- 3 2. A system is considered ‘replaced’ when the costs of replacement work equal or
4 exceed 50% of the cost of replacing the entire system. In the case of properties with
5 multiple buildings, “entire system” refers to the referenced system of all buildings.
6

7 C. Eligible Construction Activities by Program

- 8 1. Section 223(a)(7): Repairs and Level 1 Alterations are permitted provided that they
9 do not result in physical impacts or changes that cannot be described as routine
10 maintenance. In no event shall the aggregate costs of such repairs and alterations
11 exceed 1% of the estimated replacement cost of the building(s).
12 2. Section 223(f): Repairs and Level 1, Level 2 and Level 3 Alterations are permitted
13 provided that the aggregate of all such repairs and alterations is not substantial
14 rehabilitation as defined below;
15 3. Sections 220, 221, 231, 241(a): new construction and all repair and alteration
16 activities are permitted.
17

18 D. Substantial Rehabilitation

19 Substantial rehabilitation is any scope of work described for existing buildings of a
20 property where the scope:

- 21 1. Exceeds in aggregate cost a sum equal to the base per dwelling unit limit times the
22 applicable High Cost Factor; or
23 2. Replaces two or more building systems.

24 The base per dwelling unit limit was established at \$6,500 in 1983 and is now obsolete
25 because of inflation in construction costs over the past 30 years. The base limit is revised
26 to \$15,000 per unit, and will be adjusted annually based on the percentage change
27 published by the Consumer Financial Protection Bureau or other inflation cost index
28 published by HUD.
29

30 E. Extent of Substantial Rehabilitation – Gut Rehabilitation

31 For some purposes (e.g., defining the scope of work for a CNA or benchmarking utility
32 consumption) the extent of substantial rehabilitation must be further defined to recognize
33 when analysis of past building performance is relevant for predicting future results.
34 When a rehabilitation scope of work retains little more than the structural frame of a

1 building the past performance of the existing building is of limited relevance. Estimates
2 of future results should be based on proposed plans and specifications, as in new
3 construction. This level of rehabilitation is often called “gut rehabilitation.” When the
4 property is composed of a single building gut rehabilitation is defined as Level 3
5 Alterations. When there are multiple buildings, gut rehabilitation is defined as Level 3
6 Alterations in buildings which represent 75% or more of the total building area of the
7 property.

8
9 F. Substantial Rehabilitation—Section 223(f)-- Three Year Rule Lookback

10 It may be necessary to apply the definition of substantial rehabilitation retrospectively for
11 Section 223(f) applications subject to the three year rule, i.e., market rate projects
12 ineligible if the property was constructed or substantially rehabilitated within three years
13 of application, or within 6 months of sustaining occupancy for Low Income Housing Tax
14 Credit and greater than 90% Project-based Section 8 transactions. Owners of existing
15 properties often complete repairs and alterations as part of ongoing capital replacements
16 or to maintain or upgrade properties in preparation for a capital transaction. If these
17 repairs and alterations exceed the thresholds described in paragraph D above, a property
18 subject to the three year rule is not eligible for Section 223(f). When applying the
19 thresholds retrospectively, exclude:

- 20 1. Repairs and alterations completed prior to three years before the date of application;
21 and
22 2. Repairs and alterations that would normally occur at the property as capital
23 replacements reimbursable from a Reserve for Replacement Escrow.
24 3. Do not exclude any work authorized by a building permit or construction agreement
25 dated before, but for work completed after, the beginning of the three year look back
26 period which permit or agreement describes a scope of work exceeding the
27 thresholds.

28
29
30 **5.3 Required Architectural Services and**
31 **Documentation by Construction Activity.**
32

33 The borrower must provide or engage professional design and construction expertise for the
34 preparation of construction documents as appropriate for any proposed construction activity.
35 The level of professional services and the required documentation are determined both by the
36 classification of work proposed as well as the program for which application is made. The extent

- 1 of design services and documentation needed by program and class of work are generally
- 2 summarized in the following table:
- 3

DRAFT

PROGRAM	CLASS OF WORK*	SERVICES AND DOCUMENTS		
		CNA**	DESIGN	CONSTRUCTION
223(a)(7)	None, Repairs & Level 1 Alterations less than \$1,000 per unit	Required	n/a	List of Immediate Repairs/Costs, bids for trade or component items >\$25k, dimensioned sketches of accessibility remedies, and work by qualified tradesmen
223(f)	None, Repairs & Level 1 Alterations < \$15,000/unit***	Required	n/a	Same as above
223(f)	Level 2 Alterations or any repairs and alterations =>\$15,000/unit***	Required	Registered Architect, Professional Engineer required	All above plus dimensioned drawings of reconfigured spaces, GC & HUD 2328 needed as determined by Architect
223(f)	Level 3 Alterations	Required	Registered Architect, Professional Engineer	All above plus GC required for Level 3 Alterations
220,221,231, 241(a)	All classes of work	Required	Registered Architect, Professional Engineer	Full drawings and specifications, Architect administration of construction. and GC

1
2 * More than one class of work may apply to a building or a property. Requirements for
3 Level 2 and 3 Alterations apply to the buildings or spaces where the alterations are
4 proposed (not all buildings or spaces). When Level 2 Alterations are singular or very
5 limited (e.g., alter a single space or interior, non-bearing wall) the requirement for
6 professional design services may be waived.

7 ** See Appendix 5G for how CNAs are used by class of work and program.

8 *** This \$15,000 per unit limit is different from the dollar per unit threshold for
9 substantial rehabilitation and is not adjusted for the High Cost Factor.

10
11 A. Licensing and Insurance for Design Professionals

12 1. New Construction, Substantial Rehabilitation

13 a. Architects or engineers providing required design or construction services
14 must be professionally licensed to render services in the design of buildings
15 by the State in which the project is to be constructed.

16 b. The Design Architect, the Architect administering the construction contract,
17 and all engineers providing required design and/or construction services must
18 each be covered by a policy of professional liability insurance in an amount
19 consistent with the risk of loss based on the scope, scale and cost of the
20 product designed.

21 c. The professional liability insurance policy must be maintained up through
22 acceptance of the twelve month warranty inspection period that follows Final
23 Endorsement. The professional liability insurance carrier must have and
24 maintain a rating that is acceptable to HUD.

25 d. At initial closing, each design and/or construction professional must provide
26 their certificate of liability insurance which must substantially conform to the
27 sample Certificate of Professional Liability Insurance contained in Appendix
28 5H.2.

29 2. Level 3 and/or Level 2 Alterations in Section 223(f) Transactions

30 When the services of a registered architect or engineer are required to address any
31 combination of repairs and alterations equal to or greater than \$15,000 per unit or
32 Level 2 and/or Level 3 Alterations, the design professional must meet the same

- 1 licensing and insurance requirements as for substantial rehabilitation. If the design
2 professional is retained to address Level 2 and/or Level 3 alterations where the cost of
3 all repairs and alterations does not exceed the \$15,000 per unit threshold, the design
4 professional may limit contract responsibilities and liabilities to the specific Level 2
5 reconfigured spaces or to buildings where the Level 3 Alterations occur. But when
6 costs per unit exceed \$15,000, the design professional's responsibilities and liabilities
7 apply to all alterations and repairs.
- 8 B. Evaluation and Selection of Design Professional. HUD, the borrower and the lender
9 must determine that the Design Professional is capable and qualified.
- 10 1. The Lender's construction analyst
- 11 a. Will review the Design Professional's work progress and product(s); and
- 12 b. May recommend that the borrower select another professional if the Design
13 Professional's work progress or work product(s) are found to be unacceptable.
- 14 2. Failure of the borrower to engage a Design Professional acceptable to the Lender and
15 HUD is a basis for rejection of the application.
- 16 3. In any jurisdiction where a building permit is required for the proposed scope of work
17 the Design Professional must meet the licensing and/or credentialing requirements
18 acceptable to the relevant Building Code Official and must be the design professional
19 of record for the work permitted. It is the duty of the Lender's construction analyst to
20 determine independently whether the contemplated scope of work requires a permit
21 from any state or local official and to determine that the Design Professional is the
22 professional of record. Drawings approved by the Building Code Official naming the
23 Design Professional evidence satisfaction of this duty.
- 24 C. Owner-Architect Agreement. On projects requiring licensed professional services (e.g.,
25 registered architect, professional engineer), an agreement between the Architect and the
26 owner for architectural services must be executed.
- 27 1. The owner must submit the agreement with the application for Firm Commitment.
- 28 2. For new construction and substantial rehabilitation projects the executed agreement
29 must be an AIA Document B108, Standard Form of Agreement between Owner and
30 Architect for Housing Services and must include the HUD Amendment for Federally
31 Funded or Federally Insured Projects (HUD 92408-M).
- 32 a. The scope of services shall provide all architectural, structural, mechanical,
33 electrical, civil, landscape and interior design and consulting services necessary to
34 prepare drawings, specifications and other documents setting forth in detail the
35 requirements for construction of the project. The scope of services shall also
36 provide for administration of the construction contract.

- 1 b. The scope of services must designate the responsibility for the services to be
2 provided, whether by the Architect, owner or others.
- 3 c. Additional Owner-Architect Agreements must be submitted for any part of the
4 basic design services with more than one prime professional, e.g. for site, civil,
5 mechanical, electrical engineering services, etc., or supervisory architectural
6 services. The borrower's Architect is responsible for coordinating multiple prime
7 professional contracts.
- 8 d. There may be separate agreements for design and construction services if the
9 same Architect is not employed for each. When there is a separate agreement for
10 administration of the construction contract, it must be submitted for approval
11 before initial endorsement. Where separate agreements are made, those sections
12 not applicable shall be deleted.
- 13 e. An Architect with an identity of interest with the owner or general contractor can
14 serve as the Design Architect, but cannot administer the construction contract. An
15 identity of interest is defined in the HUD Amendment.
- 16 3. For Section 223(f) transactions the Owner-Architect Agreement shall be in in a form
17 consistent with the scope of work.

18 When a registered architect or licensed engineer is employed the agreement must be
19 an AIA form of agreement appropriate for the scope of work, most likely the B104
20 for projects of limited scope or the B105 for residential or small commercial projects.

21

22 D. Modification of B108 Owner-Architect Agreement for New Construction and Substantial
23 Rehabilitation. The document may be changed to reflect the actual agreement between
24 owner and Architect for the specific project.

- 25 1. Generally modifications can be made by striking out inapplicable provisions and
26 inserting additional provisions in Article 12. Adding directly to a specific provision
27 is also acceptable.
- 28 2. Changes shall not delete any service, either by the Architect or owner, necessary to
29 the project, although the responsibility for a required service may be transferred.
 - 30 a. The document shall provide a clear and definite statement of how responsibility
31 for providing any required service is to be divided between Architect, owner and
32 others. Documents must conform to requirements in Section 5.3.C.2 above.
 - 33 b. Required services may not be sublet or delegated to any one not identified to and
34 approved by HUD.
- 35 3. The Architect's fee must be a fixed fee for the services provided by the Architect as
36 stated in the Agreement. No other method of stating compensation is acceptable.
37 Separate fee amounts for design services and for construction services must be stated.

- 1 4. Where the Architect's basic fee exceeds that which may be paid from mortgage
2 proceeds or where the Owner-Architect Agreement provides for reimbursable expenses
3 (note that reimbursable expenses may not be paid from mortgage proceeds), the
4 person/entity responsible for such extra fees must be identified on the HUD
5 Amendment.
 - 6 5. HUD shall not be incorporated into any specific provision of the Agreement and the
7 inclusion of the HUD Amendment in Article 12 (enumeration of Special Terms and
8 Conditions) is sufficient to incorporate HUD requirements. No modification of the
9 HUD Amendment is permitted.
 - 10 6. The Lender's construction analyst must review the agreement for compliance with
11 these instructions.
- 12 E. Architectural Considerations in Industrialized Housing (New Construction). The
13 Lender's analyst must contact the Production Chief of the Multifamily Regional Center
14 or Satellite Office to approve the use of industrialized (aka "modular") housing.
15 Architectural and engineering services are required for off-site construction of housing
16 (modules or panels) and the fees for such services must be included in the cost of each
17 manufactured unit. The Lender's construction analyst must determine the acceptability of
18 such services by examining the drawings and specifications. In addition architectural
19 services are required for on-site construction including site work and a prepared
20 foundation for the installation on-site of modules or panels constructed off-site. These
21 services are provided by the project architect.
- 22 a. The exhibits for off-site work shall be equal in quality to the typical construction
23 documents prepared by Architects engaged in designing the type of housing
24 proposed and should include the working drawings and specifications for the
25 typical industrialized housing unit, along with an assembly or installation plan and
26 proper manufacturer's warranty document which must cover not only off-site
27 construction but also transit and delivery and the efficacy of the on-site assembly
28 or installation plan.
 - 29 b. Additional professional services may be required to provide a complete set of
30 construction documents. These services must be determined by the Lender's
31 construction analyst for each project based on the percentage of the construction
32 documents for the project that may be provided by the housing manufacturer.
33 Usually, the architect will integrate the manufacturer's drawings into his/her set of
34 drawings and specifications, adapting them to the particular project.

- 1 c. The manufacturer shall provide complete professional design services. If the services
2 meet in all respects the qualifications and quality required, the construction documents
3 shall be acceptable.
- 4 d. Owner-Architect Agreement, AIA Document B108, is required only to cover the
5 services provided by the Architect and is not required for professional services
6 provided by the housing manufacturer.
- 7 e. In all cases, an independent Architect with no identity of interest shall provide
8 general administration of the construction contract.

9 **5.4 Architectural Standards and Other Criteria**

10 Projects that are built, substantially rehabilitated, acquired or re-financed with FHA mortgage
11 insurance must meet the standards described in the Appendices to this chapter, as outlined
12 below:

- 13 A. Appendix 5A – Common HUD Standards and Criteria
- 14 B. Appendix 5B – Accessibility for Persons with Disabilities
- 15 C. Appendix 5C – Seismic and fire protection requirements for existing buildings
- 16 D. Appendix 5D – Energy codes
- 17 E. Appendix 5E – Requirements for drawings and specifications

18 **5.5 Construction Contracts**

19 New construction and substantial rehabilitation projects always require a general contractor and a
20 HUD form of contract (HUD 92442-M) and Supplementary Conditions to the Contract for
21 Construction (HUD 92554-M). Section 223(f) transactions with Level 3 Alterations require a
22 general contractor to execute an owner-contractor agreement covering at a minimum the Level 3
23 Alterations, if not necessarily all other repairs and alterations. For 223(f) transactions with any
24 combination of repairs and alterations at costs equal to or exceeding \$15,000 per unit or with
25 Level 2 Alterations, the architect shall determine whether the scope of work requires a general
26 contractor. Whenever a general contractor is engaged, the owner-contractor agreement must be
27 in writing and in a form acceptable to HUD. Construction contracts acceptable to HUD are as
28 follows:

1 A. New construction and substantial rehabilitation. The owner-contractor agreement (the
2 general contract) shall be HUD form 92442-M with Supplementary Conditions to the
3 Contract for Construction, HUD form 92554-M. These forms are coordinated with
4 Owner Architect form B108 and the HUD Amendment to the B108 (HUD 92408-M) as
5 well as with other HUD forms referenced in the Owner Architect and the Owner
6 Contractor agreements. In addition, new construction and substantial rehabilitation
7 projects require use of the Building and Loan Agreement between the borrower and the
8 lender (HUD 92441M).

9 B. Section 223(f) transactions. The AIA form of Owner Contractor agreement which
10 corresponds to the selected AIA Owner Architect Agreement must be used. Accordingly
11 if the AIA standard form B104 for projects with limited scope is used as the Owner
12 Architect agreement then the AIA A107 form of Owner Contractor agreement must be
13 used. Likewise if the B 105 is used then the A 105 Owner Contractor agreement must be
14 used. Other AIA forms for change orders, requisition of funds and related processes
15 referenced in these paired agreements should also be used in accordance with the terms of
16 the agreements.

17

18 **5.6 Streamlined Processing Instructions For** 19 **Projects Requiring Professional Design** 20 **Services**

21

22 Streamlined processing of architectural design, specification, construction, and cost estimation
23 exhibits serves two purposes. The first is to expand use of HUD mortgage insurance programs
24 for projects with Low Income Housing Tax Credits (LIHTC). The second is to expedite
25 applications for borrower development teams with clearly demonstrated capacity and experience
26 with HUD insured construction projects. Streamline processing means that less than 100%
27 complete plans and specifications may be submitted with the application for Firm Commitment.
28 Final project drawings and specifications must be submitted for HUD review and
29 comment/approval at least thirty days prior to Initial Endorsement. Permit ready drawings and
30 specifications, approved by the Building Code Official with jurisdiction subject only to the
31 payment of required permit fees and charges must be delivered not less than ten business days
32 prior to Initial Endorsement.

33 A. Applications Eligible for Streamline Processing

1 All LIHTC project applications are eligible for streamline processing of design and
2 construction documents. Other applicants should describe and discuss their qualifications
3 for streamlined processing with the MF Regional Center/Satellite Office at the concept
4 meeting or pre- application stage. To be considered qualified the borrower/sponsor, the
5 architect, the general contractor, if any, and due diligence providers, must each have
6 successful prior HUD project experience comparable in scope and scale to the scope of
7 work proposed in the application. Generally, HUD will determine eligibility for
8 streamline processing as a result of a concept meeting or pre-application. Applicants for
9 223(f) without LIHTCs and with repairs and alterations requiring professional design
10 services may request a concept meeting if they consider deferred submission of final
11 plans and specifications useful. Otherwise 223(f) applicants should provide final plans
12 and specifications with the application for firm commitment.

13 B. Other Factors Limiting Streamline Processing for Non-LIHTC Applications

14 Lenders and MF Regional Center/Satellite Offices should determine that the project will
15 achieve initial closing within sixty days after issuance of a Firm Commitment
16 conditioned upon final plan submission. Lenders and MF Regional Center/Satellite
17 Offices should also consider the complexity of the proposed design and construction
18 when determining whether to permit the deferred submission of final drawings and
19 specifications. Complex issues unsuited to streamlined processing include, but are not
20 limited to:

- 21 1. Any claim of exemption from the design and construction requirements of the Fair
22 Housing Act based on site impracticality (terrain unsuited to accessible paths and
23 building entrances);
- 24 2. Projects where costs not attributable to residential use must be calculated because
25 Criteria 4 of the form HUD 92264A, Statutory Limitations of cost per family unit is
26 material to the calculation of the maximum mortgage amount;
- 27 3. Projects with complex mixed use, commercial use, or use of new, complex
28 construction technology;
- 29 4. Projects with complex environmental remediation issues or with historic preservation
30 objectives.

31 C. Minimum Construction Documentation at Firm Commitment.

1 The Firm Commitment may be conditioned on the timely receipt and satisfactory review
2 of complete and final plans, specifications and cost estimates, provided that the Lender's
3 submission of less than 100% of the Drawings, Specifications (i.e.,
4 schematic/line/working drawings) and cost estimates provides the following detail:

- 5 1. The static footprint of the building or buildings on the surveyed site plan and, for new
6 construction, showing topography at required intervals;
- 7 2. The gross building and net residential footage;
- 8 3. Dimensioned unit layouts for each unit type for new construction or substantial
9 rehabilitation or for reconfigured spaces in Section 223(f);
- 10 4. Dimensioned floor plans, and elevations for each building type;
- 11 5. Sufficient design detail to determine the Davis-Bacon Wage rate classification for
12 new construction and substantial rehabilitation;
- 13 6. Sufficient design detail to determine compliance with accessibility requirements in
14 Appendix 5B;
- 15 7. Sufficient design detail (wall cross section details) to determine structural framing
16 and exterior wall finishes for new construction and gut rehabilitation and other repairs
17 and alterations when applicable;
- 18 8. Sufficient design detail to determine building mechanical systems;
- 19 9. Sufficient design detail to determine scope of site development and off-site
20 construction;
- 21 10. A written cost estimate (HUD-2328) from the general contractor, if any;
- 22 11. The lender's construction analyst's cost estimate (HUD 92326) for new construction
23 and substantial rehabilitation or review of repair and alteration costs for Section
24 223(f);
- 25 12. The lender's review and comparison of the general contractor's cost estimate with the
26 lender construction analyst's estimate on form HUD 92331 for new construction and
27 substantial rehabilitation;

- 1 13. For new construction and substantial rehabilitation (a) the proposed but unsigned
2 owner contractor agreement for construction (HUD 92442M) indicating any selected
3 options (e.g. incentive payments, etc.) or special conditions and the Supplemental
4 Conditions (HUD 92554M) and (b) the proposed but unsigned Building and Loan
5 Agreement (HUD 92441M). For Section 223(f), the AIA A107 or A105, if general
6 contractor is used;
- 7 14. Project Architect's or needs assessor's CNA reviewed by the lender's construction
8 analyst with the Lender's balanced financial plan for funding future capital needs, all
9 in accordance with Appendix 5G;
- 10 15. A Statement of Energy Design Intent (for new construction or gut rehabilitation) or a
11 Statement of Energy Performance (for existing buildings with less than gut
12 rehabilitation) obtained from the Environmental Protection Agency's Portfolio
13 Manager application and attached to the CNA by the Lender at submission as
14 described in Appendix 5G; and
- 15 16. For gut rehabilitation, the project architect's detailed inspection report and work
16 write-up.

17 D. Scope of HUD Review and determinations required in order to issue a Firm
18 Commitment:

- 19 1. An assessment that the estimated project cost based and the lender's cost estimate and
20 the lender's comparison of these estimates is reasonable and in line with comparable
21 HUD project data and is likely accurate within a deviation of plus or minus 5%;
- 22 2. An assessment that the borrower's and general contractor's financial capacity to
23 complete the proposed construction is not materially diminished by an increase in
24 cost of up to 5%;
- 25 3. An assessment that the proposed general contractor is acceptable pursuant to existing
26 requirements (sufficient working capital, experience, etc.); and
- 27 4. An assessment that the plans and specifications are in compliance with all applicable
28 requirements on a preliminary basis, with appropriately qualified certifications
29 executed.

1 5. The Phase I (ASTM Practice E 1527-06 or most current) environmental report must
2 contain no significant unresolved environmental issues that would justify a Form
3 HUD-4128 “Environmental Assessment & Compliance Findings.

4 D. A modification must be made to the commitment for those projects determined to be
5 eligible for deferred submission of final drawings, specifications and cost
6 estimates. Below is a sample special condition to be added to the Firm Commitment.

7 *“As an accommodation to the Borrower, this commitment has been issued and based
8 upon preliminary drawings, instead of the final drawings, specifications and cost
9 estimates. At least 30 days prior to the scheduled date for Initial Endorsement
10 [Endorsement, if pursuant to 223(f)], HUD must receive the final drawings,
11 specifications and the lender’s architectural/cost review report for review and approval
12 to ensure consistency of design and cost. In the event that there is a net cumulative
13 construction cost change of more than 5%, or a change in design concept, this
14 commitment shall be subject to and conditioned upon the further approval of HUD, to be
15 evidenced in writing. Based on such review this commitment may be terminated and
16 voided by HUD, or additional conditions may be imposed, at HUD’s option.”*

17

18 **5.7 New Construction, Standard Processing- 19 Concept Meeting through Firm Commitment**

20

21 A. Concept Meeting. The lender should arrange a concept meeting engaging HUD staff and
22 the borrower’s development team. With respect to design and construction topics the
23 purpose of the concept meeting is to establish feasibility and to identify key issues. For
24 this reason the lender should provide:

- 25 1. The name, address, contact information and resume or summary of experience, of the
26 design professional(s), due diligence providers and the general contractor if known.
27 Of particular importance is the development team’s previous experience with HUD
28 mortgage insurance programs for new construction.
- 29 2. Maps and photographs illustrating the location, boundaries, conditions and features of
30 the site, noting in particular the location and size of public utilities lines available to
31 serve the site, means of access and egress, and proximate properties.
- 32 3. The project architect’s written summary design program or concept prepared after the
33 architect’s on-site inspection and preliminary review of existing or proposed zoning,

- 1 subdivision and building code requirements. The summary should characterize the
2 contemplated number, size, and kind of buildings and dwelling units and should
3 include a conceptual site plan, and sketch plans of typical units and buildings. In
4 particular the summary design program should identify key issues presented by the
5 site and its environs, such as, but not limited to:
- 6 a. Terrain, rock or steep slopes that may require detailed exploration, unusual site
7 costs or result in any claim of site impracticality exemption from the design and
8 construction accessibility requirements of the Fair Housing Act;
 - 9 b. Absence or unavailability of public utilities requiring off site work, unusual public
10 permitting or development entitlement processes or costs;
 - 11 c. Insufficient or deficient access and egress due to limitations on existing streets
12 and grades or lack thereof and/ or traffic conditions.
- 13 4. The lender should describe existing or ongoing needs for site due diligence and
14 provide a plan or description of how due diligence tasks will be completed including
15 appropriate sequencing, coordination of studies and the identity of prospective
16 providers.
- 17 5. The lender should identify any other contemplated sources of funding that would
18 trigger design and/or construction requirements and describe such requirements (e.g.,
19 Any Federal assistance, such as HOME, will trigger Section 504 and UFAS; state or
20 local assistance, including LIHTCs, will trigger the state or local agency plan for
21 compliance with Title II of the Americans with Disabilities Act).
- 22 6. The lender should state whether streamlined processing of design and construction
23 documents is proposed and the reasons such processing is needed (e.g. use of LIHTCs
24 is expected) and realistic (e.g. development team is experienced with HUD insured
25 mortgage programs for construction, has successfully executed physically similar
26 projects and the site and/or environs present no complex challenges or prospective
27 delays.)
- 28 B. Pre-Application. The Lender's underwriter must have visited and inspected the site and
29 the Lender must submit the following Pre-application exhibits to HUD:
- 30 1. Form HUD-92013, Application for Project Mortgage Insurance;
 - 31 2. Location map with property clearly defined;

1 3. Sketch plan of the site showing overall dimensions of main building(s), major site
2 elements, (e.g. parking lots, points of access and egress, pedestrian access, and
3 accessible entrances and paths.) and location of existing utilities, (e.g. water, sewer,
4 electric, gas) in the streets adjacent to the site. Contour lines and elevations are not
5 required in the sketch site plan. However, the Lender must state whether any
6 contours or elevations observed are likely to result in a claim of exemption of any
7 proposed building or facility from the design and construction requirements for
8 accessibility of the Fair Housing Act by reason of site impracticality. (See Fair
9 Housing Design Manual 1.38). If so, the lender must confirm that it has advised the
10 borrower, the design professional(s) and the general contractor of the site feasibility
11 methodology described in the Fair Housing Act Design Manual. Similarly, the lender
12 must describe whether and how any design and construction requirements triggered
13 by other sources of funding will be met.

14 4. Sketch plans of building(s) that show:

- 15 a. Typical floor plans showing apartment types, placement and dimensions;
- 16 b. Ground floor plans showing common areas and dimensions;
- 17 c. Sketch floor plans of typical dwelling units;
- 18 d. Sketch elevations of typical buildings;
- 19 e. Residential and gross building area for each building or building type;
- 20 f. Typical wall sections showing footing, foundation, and wall and floor structure,
21 with notes indicating the basic materials to be used in the structure, floor and
22 exterior finishes.

23 5. The lender must address any physical due diligence issues identified at the Concept
24 Meeting and/or issues identified since the Concept Meeting and indicate the results of
25 and or progress in completing physical due diligence.

26 C. Firm Commitment. The Lender's construction analyst must have visited and inspected
27 the site and its environs investing time and attention to detail sufficient to allow the
28 analyst to appreciate due diligence needs and to knowledgeably evaluate prepared due
29 diligence and all design and construction documents. The lender must submit the
30 following exhibits for review provided that, if the application is approved for streamline
31 processing the following exhibits may be submitted as substantially completed drafts and
32 resubmitted as final at least 30 days prior to Initial Endorsement (See 5.6 above):

- 33 1. Form HUD-92013, Application for Project Mortgage Insurance.
- 34 2. Owner-Architect Agreement, AIA Document B108 (and HUD Amendment to the
35 B108), fully defining the services and fees for each prime design professional with

- 1 which the borrower/owner contracts directly. Additional contracts must be submitted
2 for any part of the basic design services with more than one prime professional, e.g.
3 for site, civil, mechanical, electrical engineering services, etc., or supervisory
4 architectural services. The borrower's Architect shall have the authority to coordinate
5 multiple prime professional contracts.
- 6 3. Legal Survey. The survey does not have to be new. An existing survey marked "Re-
7 surveyed" and dated within the submission time frame is acceptable, provided that it
8 is either done by the original surveyor or, if performed by a different surveyor, it must
9 also contain the seal of the new licensed surveyor.
- 10 4. Completed Surveyor's Report, Form HUD-91073M, with responses to all questions
11 and the completed HUD certification;
- 12 NOTE: The American Land Title Association/American Congress on Surveying and
13 Mapping (ALTA/ACSM) has its own mandatory certification language that differs in
14 wording from HUD's mandatory certification language on Form HUD-92457M.
15 HUD will permit the required ALTA/ACSM certification to appear on the survey
16 map/plat.
- 17 5. Engineering and specialty reports, e.g. geotechnical, environmental, noise, flood
18 hazard, toxic hazard, termite control, structural, heat gain/loss calculations, etc.
- 19 6. Municipal and utility company letters of confirmation for the provision of services
20 and/or offsite improvements.
- 21 7. Any documents necessary to establish:
- 22 a. Site ingress and egress, utilities service and other general acceptability criteria in
23 MPS 4910.1, Chapter 2.
- 24 b. Binding or signature ready drafts of proposed joint use, access and maintenance
25 agreements where common use easements (e.g., driveways) are existing or
26 proposed. When recorded easements and restrictions exist they must be
27 evidenced on the survey. When proposed, easements should be platted and
28 agreements drafted for review in preparation for recording.
- 29 8. Certifications from borrower's Architect that:
- 30 a. Foundation designs reflect site soils limitations and design recommendations
31 included in the foundation soils report and any other geotechnical reports;
- 32 b. All project structures, amenities, and site improvements are in full compliance
33 with:
- 34 (1) The design and construction requirements of the Fair Housing Act (42 USC
35 3404(f)(3)(C), and 24 CFR 100.205);
- 36 (2) Title III of the American's with Disabilities Act (for public accommodations);

1 (3) If the property is Federally assisted, Section 504 of the Rehabilitation Act of
2 1973 and its implementing regulations at 24 CFR Part 8;

3 (4) As well as with any state or local government requirements for accessibility
4 for persons with disabilities including state or local measures to implement
5 Title II of the Americans with Disabilities Act concerning state and local
6 programs.

7 (See Appendix 5B)

8 9. Contract drawings and specifications that conform to the specific format and
9 requirements described in Appendix 5E.

10 10. Offsite Construction: Describe all work essential to the project but outside the
11 boundaries of the property (see Appendix 5E).

12 11. The general contractor's Cost Breakdown, form HUD 2328.

13 12. The Lender's CNA based on proposed construction plans and specifications to be
14 built and completed and submitted via the CNA e Tool in accordance with Appendix
15 5G and including:

16 a. A Statement of Energy Design Intent (SEDI) from EPA's Portfolio Manager
17 based on projected utility consumption of the buildings to be built in accordance
18 with the plans and specifications. This projection must be prepared by the Project
19 Architect or another licensed or certified professional retained for this purpose.
20 The SEDI must show a minimum energy score of 60. Note that the SEDI
21 minimum score is a requirement in addition to and not in lieu of the obligation to
22 prepare plans and specifications meeting the requirements of the International
23 Energy Conservation Code or the ASHRAE standard 90.1. See Appendix 5D for
24 minimum energy code requirements.

25 b. A completed physical inventory of the property to be built, (that is, description of
26 site, buildings, units, utility types and rates, components and alternatives in the
27 CNA e Tool).

28 c. An estimate of replacement cost, as new, for each structure (form HUD 92329,
29 Schedule of Insurable Values) which cost should in the aggregate be consistent
30 with the lender's construction analyst's estimate of costs for structures including
31 general requirements, contractor's overhead and profit.

- 1 d. The lender’s financial plan for funding future capital replacement needs based on
2 actual expected replacements with appropriate adjustments for inflation and other
3 variables as described in Appendix 5G. The financial plan will define the
4 schedule of annual deposits to the Reserve for Replacement escrow.
- 5
- 6 13. The Lender construction analyst’s detailed cost estimate package composed of the
7 following:
- 8 a. Detailed cost estimate to be reported on Form HUD-92326.
- 9 b. A comparison of the general contractor’s trade line item cost estimate (HUD
10 2328) with the lender construction analyst’s estimate (HUD-92326) with
11 comments and explanations described on form HUD 92331.
- 12 c. The lender construction analyst must sign and date the HUD-2328 in the FHA:
13 Processing Analyst box. The Lender’s underwriter must sign and date the HUD-
14 2328 in the FHA: Chief Cost Branch or Cost Analyst box.
- 15
- 16 14. The Lender construction analyst’s completed architectural and cost sections of the
17 form HUD 92264. The analyst must sign and date the form as both “Cost Processor”
18 and “Architectural Processor.” If different analysts execute the architectural and the
19 cost reviews then each must sign as appropriate.
- 20
- 21 15. The Lender construction analyst’s review and disclosure of identities of interest and
22 application of the 50%-75% Rule (See Chapter 13, sections 13.16 M and 13.17 for
23 instructions on this rule.)
- 24
- 25 a. Identify and describe any identity of interest relationships between or among the
26 Borrower, any of the Borrower’s design professionals, the general contractor, any
27 subcontractors, material suppliers, equipment lessors, or manufacturers of
28 industrialized housing.
- 29 b. Identify by analysis of the HUD 2328 any single subcontractor that executes 50%
30 or more of the total construction or any three subcontractors who in the aggregate
31 execute 75% or more of the total construction measured by dollar value.
- 32

- 1 16. The proposed but unsigned owner contractor agreement for construction (HUD
2 92442M) indicating any selected options (e.g. incentive payments, etc) or special
3 conditions, the Supplemental Conditions (HUD 92554M) and the proposed but
4 unsigned Building and Loan Agreement (HUD 92441M).
- 5 17. Review Report prepared by Lender's construction analyst who must state that all exhibits
6 are acceptable without conditions, and that all deficiencies have been acceptably corrected
7 except that in the case of an application approved for streamlined processing this statement
8 may allow for the contingency that final plans, specifications and cost estimates have not
9 been completed. The report should address the following:
 - 10 a. Completeness of construction and contract documents;
 - 11 b. Conformance to local building codes and HUD standards;
 - 12 c. Accessibility for persons with disabilities. Refer to the Fair Housing Act design
13 and construction requirements for accessibility found at 24 CFR 100.205. If the
14 property is federally assisted, refer also to the Uniform Federal Accessibility
15 Standard. For any public accommodations at the property (e.g. leasing office,
16 commercial space), refer to Title III of the Americans with Disabilities Act (See
17 Appendix 5B).
 - 18 d. Site design:
 - 19 (1) Placement of buildings, roads, walks and parking on the site;
 - 20 (2) Identification and review of offsite construction;
 - 21 (3) Site erosion and storm drainage; and
 - 22 (4) Soil borings report.
 - 23 e. Building design:
 - 24 (1) Building circulation:
 - 25 (a) Adequacy of elevators;
 - 26 (b) Number and placement of stairs;
 - 27 (c) Adequacy of lobbies and corridors; and
 - 28 (d) Adequacy of fire egress.
 - 29 (2) Typical dwelling units: Adequacy of room sizes and circulation within
30 units.

- 1 (3) Fire safety: Provision of adequate fire safety measures, e.g. fire sprinklers,
2 firewalls, fire doors (if required).
- 3 (4) Structural adequacy: Review of building structure and structural details
4 including measures implemented to address identified hazards such as
5 seismic risk, coastal high wind and/or flood zones.
- 6 (5) Mechanical, electrical and plumbing adequacy: Review of mechanical and
7 electrical and plumbing plans.
- 8 (6) Energy efficiency. Review utility combination for energy efficiency and
9 determine acceptability of utility combination. Review and submit the
10 Capital Needs Assessment in the CNA e Tool per Appendix 5G. See
11 Appendix 5D for applicable International Energy Conservation Code and
12 ASHRAE standards for new construction.
- 13 f. Submit copies of the Lender's construction analyst's project files and logs only if
14 requested by the HUD Office.
- 15 g. Standard certification by Lender's construction analyst(s) (see Chapter 11 Section
16 11.2).

18 **5.8 Firm Commitment through Initial Endorsement –** 19 **New Construction**

- 21 A. Changes after Firm Commitment. Prior to initial endorsement except for projects
22 submitted as streamlined applications:
 - 23 1. Drawings and specifications may be amended by addendum when the change(s) will
24 have no effect on cost or value. The Lender's analyst must review the addenda for
25 acceptability.
 - 26 a. Addenda must clearly state or show the change with specific reference to the
27 location of the item on the drawings or in the specifications.
 - 28 b. Amendments shall be clearly noted and dated.
 - 29 c. Addenda are not to be used to correct errors noted during Firm Commitment
30 processing.

- 1 2. Firm Commitment reprocessing is required for major changes adding or deleting
2 work, or affecting cost or value. Drawings and specifications affected must have
3 sheets and pages revised and replaced.

- 4 B. Contractor’s Estimated Progress Schedule. Article 3.10.1 of the AIA General Conditions
5 requires the general contractor to prepare and submit an “estimated progress schedule for
6 the work” to the borrower and Architect. (See instructions for how to prepare the
7 progress schedule in this Chapter at 5.11.D.5)
- 8 1. The borrower or Architect must submit a copy to the Lender’s analyst at least 30 days
9 before Initial Endorsement and a final copy must be provided with the permit ready
10 drawings not later than 5 days prior to endorsement.
- 11 2. The Lender’s analyst must review the schedule to assure it relates to the entire project
12 to the extent required by the contract documents, inclusive of dates for the stages of
13 construction.
- 14 Copies of the approved schedule are distributed with other construction contract
15 documents at Endorsement and used to monitor construction progress.

- 16 C. Contract Documents. The Lender shall submit the following contract documents to
17 HUD’s architectural staff for review and approval prior to Initial Endorsement:
- 18 1. Final, signature ready drafts of the Building Loan Agreement, Form HUD-92441M,
19 the Construction Contract, Form HUD-92442M and the Supplemental Conditions to
20 the construction contract (HUD 92554M).
21 a. Assure the correct identification of drawings and specifications on contract forms.
22 (1) Project name, HUD project number, and design Architect’s name.
23 (2) Drawings and specifications by sheets, pages and date or by index with
24 date of last revision of sheet and page.
25 (3) Addenda, if any, by number and date.
26 b. Assure compliance with any architectural requirement or condition.
- 27 2. Survey and Surveyor’s Report, Form HUD-91073M, which must be reviewed:
28 a. For compliance with Survey Instructions and Certificate.
29 b. To confirm that the legal description and survey property boundaries agree.
30 c. To assure that the surveyor’s report is complete per instructions.
31 d. To confirm consistency of the approved plans and site plan with the survey and
32 the description of any easements, joint use and access agreements, dedications of
33 land for public rights of way, and state or local subdivision requirements.

- 1 3. Drawings and Specifications. Submit three sets and confirm that:
 - 2 a. Master Sets No. 1, 2 and 3 are the same as accepted and identified in the Firm
3 Commitment. (For projects approved for streamlined processing, the Lender must
4 confirm that the final plans and specifications are acceptable, complete and
5 consistent with Firm Commitment exhibits.) Indicate the total number of pages in
6 the drawings and specifications. HUD may, at its discretion, eliminate the
7 requirement for set No. 2 (HUD review set).
 - 8 a. Cover and last drawing sheets, and the first and last specification pages of all sets,
9 are signed by representatives of the design Architect, Architect administering the
10 contract, owner, contractor, Lender and bonding company, if any.
 - 11 b. Master Set is bound and signed as described above on the cover sheet and last
12 sheet of the drawings and the first and last pages of the specifications. Signatories
13 must initial opposite any “last minute” revisions not covered by Firm
14 Commitment or addendum. The master set must be identified as such.
 - 15 c. Lender signatory is an individual or individuals who are authorized to sign at
16 closing, and who must sign and initial the plans and specifications (see Appendix
17 5E). HUD will only accept the Lender’s authorized signatory, who must be
18 identified as such for HUD by the Lender.
- 19 4. Drawings and Specifications. Lender must retain one set and confirm that the:
 - 20 a. Lender set is the same as the set that was accepted and identified in the Firm
21 Commitment (or approved after Firm Commitment per streamline processing).
22 Indicate the total number of pages in the drawings and specifications.
 - 23 b. Cover sheets are signed by representatives of the design Architect, Architect
24 administering contract, owner, contractor, Lender and bonding company, if any.
 - 25 c. Lender set is signed by signatories on the cover sheet and the last sheet of the
26 drawings and the first and last pages of the specifications. Signatories must initial
27 opposite any “last minute” revisions not covered by Firm Commitment or
28 addendum or as approved per streamline processing.
- 29 D. If contract documents are correct, the HUD Senior Underwriter will recommend Initial
30 Endorsement. In the event of errors or inconsistencies, the contract documents will be
31 returned to the Lender for correction and resubmission.
- 32 E. Distribution of Drawings and Specifications.

- 1 1. After Initial Endorsement, HUD will distribute the drawings and specifications as
2 follows:
 - 3 a. Set No. 1, Master Set, is the legal contract document. HUD will:
 - 4 (1) Retain this set until the last guarantee inspection.
 - 5 (a) Add a copy of each Change Order, Form HUD-92437.
 - 6 (b) Add a copy of each Architect's Supplemental Instruction.
 - 7 (2) Package the specifications in a tightly rolled bundle with drawings on the
8 outside, attach a memo indicating the HUD project number, and send it to the
9 Regional Federal Records Center one year after completion of construction.
 - 10 b. Set No. 2 is the HUD Office's review set.
 - 11 (1) HUD staff will use this set for processing change orders, review of inspections
12 and similar functions.
 - 13 (2) Dispose of this set after Final Endorsement.
 - 14 c. Set No. 3 is the HUD Office's job site set.
 - 15 (1) The HUD Inspector will use this set for inspection of the project.
 - 16 (2) The HUD Inspector will conform this set to the contractor's "record set." (The
17 Contractor is required to maintain at the site a record set for the Owner.)
 - 18 (3) HUD Inspector will return this set to the HUD Office upon completion of
19 construction. This set is the HUD "as-built" set.
 - 20 (4) Use this set for guarantee inspections.
 - 21 (5) Send the "as-built" set to the Hub Director, one year after completion of
22 construction, for use in loan servicing.
 - 23 2. Drawings and specifications to be maintained by the Lender (the Lender set):
 - 24 a. The Lender must maintain this set for a period of three years after Final
25 Endorsement.
 - 26 (1) Add a copy of each Change Order, Form HUD-92437.
 - 27 (2) Add a copy of each Architect's Supplemental Instruction(s).
 - 28 b. If the originating Lender will not administer the construction contract, the
29 Construction Administering Lender must forward copies of each Change Order
30 and Architect's Supplemental Instruction to the originating Lender for inclusion
31 in the Lender Set.
- 32 F. Early Start of Construction. Construction may not start before initial endorsement and
33 recordation of the insured mortgage, except with the prior approval of the Director of the

1 MF Regional Center/Satellite Office. Any work performed after receipt by HUD of the
2 initial application constitutes an early start of construction. Work such as clearing,
3 grading, or other minor preliminary work may or may not constitute an early start of
4 construction. HUD staff must confirm this work during the review stage of the
5 application and the MF Regional Center/Satellite Office Director may approve. No
6 work shall proceed without the borrower obtaining and evidencing all state or local
7 approvals or permits requisite for that work.

8
9 The following are mandatory conditions for approval of an early start of construction:

- 10 1. Firm Commitment. There must be a valid outstanding Firm Commitment, including:
- 11 a. Site control, and the right to legally access the site for purposes of construction.
 - 12 b. HUD-approved set of contract drawings and specifications on file. See Appendix
13 5E for required Firm Commitment contract drawings and specifications.
 - 14 c. Required construction contract and other construction documents, including, but
15 not limited to:
 - 16 (1) Construction Contract, Form HUD-92442M;
 - 17 (2) Supplementary Conditions of the Contract for Construction, Form HUD-
18 92554M;
 - 19 (3) Applicable Davis-Bacon wage decision (supplied by HUD Labor
20 Relations);
- 21 3. Assurance of Completion for On-Site and Off-Site work. The early start may not
22 hamper the ability to obtain a title policy when the loan goes to initial closing.
- 23 4. Valid Basis for Early Start. The Hub Director must document the file including the
24 reason for granting an early start, after determining that:
- 25 a. An immediate closing is not practical.
 - 26 b. There is reasonable evidence and assurance that closing will occur in the near
27 future.
 - 28 c. There is a compelling need to start construction before the anticipated closing
29 date.
 - 30 d. An early start of construction will not be detrimental to HUD's interests.
 - 31 d. HUD has no insurance obligation or liability whatsoever for costs incurred during
32 an early start if the project does not reach endorsement.
- 33 5. The contractor, borrower and Lender must execute Form HUD-92415, Request for

- 1 instance, the CNA must include an ASHRAE Level II Energy Audit when the
2 buildings are 10 or more years old. The lender and project architect must describe a
3 process consistent with Appendix 5G and a timeline for evaluating the existing
4 buildings and developing the scope of work with supporting due diligence.
- 5 2. Seismic threshold for retro-fit analyses. Appendix 5C defines a step by step process
6 for determining whether seismic conditions warrant further analyses of existing
7 buildings in accordance with the most recent standards of the American Society of
8 Civil Engineers (ASCE). The threshold is easily determined, requires no on-site
9 analysis or observation of buildings or sites and should be provided at the concept
10 meeting to indicate whether seismic analyses are required. (The CNA e Tool requires
11 a determination of these same threshold values.)
- 12 3. Other Due Diligence Studies or Reports. The lender should describe the existing or
13 expected due diligence analyses including lead based paint inspection for buildings
14 constructed prior to January 1, 1978, buildings with asbestos materials and any other
15 known or reasonably anticipated hazards. (See Chapter 9)
- 16 B. Pre-application. The Lender's exhibits for pre-application are the same as those for new
17 construction with these additional items:
- 18 1. A definitive work plan for the preparation of detailed plans,
19 specifications and cost estimates including whether existing
20 conditions will be evaluated by means of the CNA under
21 the supervision of the architect or by the architect's detailed
22 inspection of the property. A CNA should be used when
23 the scope of work is less than gut rehabilitation. When a
24 CNA is used, the list of immediate repairs generated by the
25 CNA e Tool is the Architect's detailed work write-up and
26 cost estimate. In cases where intended refinance
27 applications are found to be substantial rehabilitation by
28 reason of the required scope of work discovered through a
29 CNA, the Architect, should review the CNA and should
30 also conduct a detailed inspection and update the CNA as
31 required. When gut rehabilitation is contemplated the CNA
32 should be completed after the preparation of, and based
33 upon, plans and specifications to be built as if for new
34 construction (See Appendix 5G). The plan should identify

- 1 the due diligence professionals to be engaged and describe
2 their qualifications. The composition of the due diligence
3 team should address the issues foreseeable based on the
4 borrower's objectives and the architect's and the Lender's
5 observations during a preliminary inspection of the
6 property. The results of more advanced due diligence (e.g.,
7 a completed CNA or detailed inspection by the design
8 team) should inform the pre-application when such due
9 diligence has already been completed per the consensus on
10 methods determined at the concept meeting.
- 11 2. Joint inspection. Past practice has relied upon joint
12 inspections by HUD staff and the project design team to
13 assess existing conditions. This was necessary in part
14 because CNAs were not prepared for or used in most
15 substantial rehabilitation applications. Such assessments
16 are now integrated into the process for defining the scope
17 of work for rehabilitation. Accordingly, the purpose of the
18 joint inspection is as follows:
- 19 a. To assure that HUD staff, the Lender's underwriter and construction analyst, and
20 the borrower's architect, engineer and general contractor have a common
21 understanding of physical conditions at the site. It is useful for the local Building
22 Code Official or his representative to be present, particularly in the case of older
23 properties with building methods or technologies no longer commonly used in
24 construction or with buildings that lack life safety and fire suppression measures
25 or adequate means of emergency ingress/egress.
- 26 b. To assure that all due diligence inquiry and physical investigation needs have or
27 will be identified and addressed, and/or to assist in achieving consensus (or
28 confirming an existing consensus) on methods and procedures to be used to
29 evaluate conditions and prepare the rehabilitation scope of work.
- 30 c. The joint inspection should be arranged and documented by the Lender with
31 minutes and conclusions distributed in writing to all participants.
- 32 d. The joint inspection should be scheduled as early as feasible and may follow the
33 concept meeting. If not scheduled prior to the pre-application, it must be
34 scheduled promptly following the pre-application and before the execution of
35 further due diligence or design work.

- 1 e. Except for LIHTC projects, a decision on any request for streamlined processing
2 should be made only after the joint inspection, or subject to the completion of the
3 joint inspection.
- 4 3. Given the more contingent and variable circumstances
5 typical of work with existing buildings (by contrast with
6 new construction) any borrower or lender request for
7 streamlined processing of design and construction
8 documents for substantial rehabilitation (other than LIHTC
9 projects) must include documentation demonstrating prior
10 experience and capacity in properties of similar scale,
11 condition and building technologies employed. This
12 demonstration should be made for each participant:
13 sponsor, architect and design consultants, needs assessor
14 and any due diligence consultants, general contractor and
15 the Lender's construction analyst.
- 16 4. Sketch plans of the existing building(s) "as-is".
- 17 5. A determination of the year built for each building and
18 whether each building was built for first occupancy after
19 March 13, 1991 using dates of occupancy permits and
20 building permits when any doubt exists. (If a CNA is
21 prepared, the CNA e Tool will require the needs assessor to
22 obtain and supply this information.) If first occupied after
23 March 13, 1991, then each such building must conform to
24 the design and construction requirements of the Fair
25 Housing Act (42 USC 3404(f)(3)(C), and 24 CFR
26 100.205). See Appendix 5B.
- 27 6. A determination by the Lender of whether the property is,
28 is proposed to be or ever has been Federally assisted. (The
29 CNA e Tool requires this information.) If so, then the
30 property must conform to the Uniform Federal
31 Accessibility Standards and the requirements of 24 CFR
32 8.23, 8.26, 8.31, and 8.32. See Appendix 5B.
- 33 7. Basic Work Write-up: Description of the proposed rehabilitation (from preliminary
34 inspection of the property conducted by borrower's Architect), including post-

- 1 rehabilitation sketch plans. This may precede the architect's detailed inspection and
2 the Detailed Work Write-up and/or the CNA, or if a CNA has already been prepared,
3 the List of Immediate Repairs generated by the CNA e Tool can be the basic work
4 write up and cost estimate.
- 5 8. Lead based paint (LBP) test reports for projects constructed prior to January 1, 1978,
6 and asbestos report (see LBP and asbestos standards in Chapter 9). Delivery of these
7 due diligence items may be deferred until firm commitment if consistent with and
8 scheduled as part of an agreed work plan for due diligence.
- 9 C. Firm Commitment Stage. The lender shall submit final plans, drawings, specifications and
10 costs analyses and unsigned contract agreements similar to applications for new construction
11 except as follows:
- 12 1. Borrower's Architectural/Engineering and Cost exhibits for substantial rehabilitation
13 based on due diligence studies and the examination of existing conditions. When a
14 CNA is used to develop the scope of work, and only limited drawings are required to
15 document reconfiguration of selected spaces, or shop drawings detailing selected
16 items (e.g. window and door replacement/installation or new or closed openings,
17 kitchen or bath plans or similar Level 2 Alterations) are used, these drawings should
18 be attached to the CNA when it is submitted and the component alternatives form of
19 the Assessment tool used to provide detailed specifications. Alternatively detailed
20 specifications may be prepared separately and keyed to alternative components
21 selected in the CNA e Tool and the specifications attached to the CNA at submission.
22 Documents prepared in or attached to the CNA in the CNA e Tool may be printed in
23 the requisite sets and copies for signature and distribution at Initial Endorsement.
24 Otherwise, plans and specifications should be prepared and submitted in the same
25 manner as for new construction.
- 26 2. Review Report prepared by Lender's construction analyst covering the scope of work
27 and the detailed work write-up.
- 28 3. Area and unit count breakdowns for multiple structure projects will be recorded in the
29 CNA, whether prepared for existing structures to be rehabilitated or as if for new
30 construction. When properly completed, the CNA e Tool will report this information.
- 31 4. Operation and Maintenance Plans. For projects that contain lead based paint (LBP),
32 asbestos or have ongoing risks such as radon that may require permanent installation
33 of ventilation, detection or alarm devices, the borrower or Architect is responsible for
34 engaging the services of qualified abatement contractor(s) to prepare a scope of work
35 for the abatement or mitigation. Where the scope of abatement work consists of

1 permanent enclosure or encapsulation or ongoing monitoring, but not removal, the
2 qualified abatement contractor(s) must also prepare, separate from the scope of
3 abatement work, an Operations and Maintenance (O&M) Plan which contains
4 ongoing maintenance activities to be followed for as long as the hazard remains in
5 place. All abatement work and ongoing maintenance activities for radon, LBP,
6 asbestos, and/or any other hazards shall conform to the requirements described in
7 Chapter 9.

8
9 The Borrower must certify that the borrower has prepared an O&M Plan. A
10 condition shall be attached to the firm commitment requiring that the borrower
11 operate and maintain the property consistent with the referenced O&M plan for the
12 duration of the insured mortgage.

- 13 5. Due diligence, engineering, energy audit and related studies, abatement plans and
14 O&M Plans, and reports should be attached to the CNA when an assessment is used
15 to prepare the scope of work.
- 16 6. Similarly, when the CNA is used to develop the scope of work, cost of repairs is
17 itemized in the CNA e Tool. The summation of these costs in the standard trade
18 breakdown and general contractors estimate (HUD 2328) and the Lender construction
19 analysts detailed estimate (HUD-92326) and the analysts comparison of estimates
20 reported on HUD form 92331 together with the architectural and cost portions of the
21 HUD 92264 signed by the construction analyst should all be attached to the CNA
22 when submitted by the lender.
- 23 7. For gut rehabilitation when the CNA is prepared based on plans and specifications to
24 be built (as for new construction) then due diligence, engineering and related studies,
25 O&M Plans, if any, and the lender construction analyst's cost package are submitted
26 in the same manner as for new construction.
- 27 8. When the property to be rehabilitated is a historic property or in a designated historic
28 district the review of the State Historic Preservation Office is required and must be
29 provided not later than at the application for firm commitment. (See Chapter 9)

- 30 D. Firm Commitment to Initial Endorsement. After firm commitment and not later than 30
31 days prior to Initial Endorsement, the Lender must assemble the final, printed plans,
32 drawings, specifications, construction schedule and contract forms. Even if such
33 documents were submitted as attachments to the CNA e Tool, or otherwise electronically
34 submitted, they must still be printed, and signed in the requisite number of counterparts

1 as described in Section 5.8 and confirmed as sufficient, authentic and final documents for
2 contract purposes.

3 4 5 **5.10 Processing for Refinance or Acquisition,** 6 **Section 223(f) and 223(a)(7) and 241(a) for** 7 **Repairs and Alterations**

8
9 In general, all the previous instructions in this chapter apply to projects insured pursuant to
10 Section 223(f) and 223(a)(7) and Section 241(a) supplemental loans for repairs and alterations,
11 except as modified below.

- 12 A. Architectural Standards. Eligible properties are existing buildings and the criteria for
13 acceptance are not the same as for proposed construction. See Appendix 5 for
14 architectural standards for existing buildings.
- 15 B. Limitation on Repairs for 223(a)(7). The intent of the 223(a)(7) program is to provide a
16 simple and speedy refinance option for existing insured properties when lower interest
17 rates or extended amortization periods improve cash flow, reduce the risks of default and
18 improve overall financial performance. Accordingly, repairs that reconfigure space are
19 not permitted except for limited dimensional changes as remedies for accessibility
20 deficiencies. In terms of the classification of work, this means repairs and Level 1
21 Alterations (excepting accessibility deficiency items as noted.) Moreover, no
22 environmental review is intended for 223(a)(7) applications, and so repairs and
23 alterations should be limited to those considered to be routine, periodic maintenance or
24 for the correction of deficiencies; the total cost of which should not exceed an amount in
25 excess of \$1,000 per unit.
- 26 C. Neither concept meetings or pre-applications are needed for 223(a)(7) applications and
27 are not required for 223(f) applications, so firm commitment applications may be
28 submitted directly to HUD for review. A concept meeting may be advisable for 223(f)
29 applications where expected Repairs, Level 1 and Level 2 Alterations (or Level 3
30 Alterations in some buildings) are significant and may approach or exceed the threshold
31 definition of substantial rehabilitation (See 5.2.D). In that event, the purpose of the
32 concept meeting is to determine the scope of work, or to establish agreed upon due
33 diligence that will determine or confirm the scope of work.

- 1 D. A CNA is required for all applications. The Lender must retain a qualified needs
2 assessor who must complete the assessment in accordance with Appendix 5G not earlier
3 than 180 days prior to the application for Firm Commitment, provided that in the case of
4 223(a)(7) applications for properties with no or nominal required repairs, a CNA may be
5 accepted if:
- 6 1. It is dated not more than 2 years prior to the date of application for Firm
7 Commitment;
 - 8 2. The MF Regional Center/Satellite Office Supervising Project Manager or Director
9 approves the use of the existing CNA for purposes of the application;
 - 10 3. The CNA contents and scope conform to the requirements of Appendix 5G including
11 the use of the CNA e Tool for its preparation and submission; and
 - 12 4. The mortgagor and lender are required to provide a new CNA not later than 10 years
13 after the date of the CNA accepted with the application.
- 14 E. Stale Needs Assessments. In the event that the Lender fails to submit an acceptable
15 application for Firm Commitment within 180-days from the date of needs assessment,
16 then the Lender must order an updated CNA. The needs assessor must re-inspect the
17 subject property, updating any structure and/or site conditions observed, and date and
18 sign a new Third Party Certification.
- 19 F. By submission of the CNA through the CNA e Tool, the Lender certifies that it has
20 selected a qualified needs assessor with no conflicts of interest in the transaction and has
21 reviewed the assessment for completeness, accuracy, reasonableness and conformance to
22 HUD requirements. (See Appendix 5G for certification language.)
- 23 G. Other required architectural/engineering/cost exhibits which the Lender must attach to the
24 CNA at submission are:
- 25 1. A completed A/E portion of Form HUD-92264.
 - 26 2. Certificate of Occupancy or Final Inspection Report, if available or a statement from
27 the jurisdiction of authority recognizing a conforming use.
 - 28 3. Municipal Code Violation Report/Clear Report, and Fire Marshall's Report/Clear
29 report.
 - 30 4. City/County Health Officer's report/clear report where private water supply or
31 sewage treatment systems are involved.

- 1 5. Location map.
- 2 6. Aerial photography or satellite view of site.
- 3 7. Set of as built plans, if available.
- 4 8. Annotated photography and other physical diligence reports as needed based on
- 5 observed conditions, in accordance with Appendix 5G
- 6 H. Form HUD 92013 must be completed and submitted with the application for firm
- 7 commitment.
- 8 I. An “As Built” survey, Form HUD-91073M, Surveyor’s Report; and Title Report. For
- 9 specific survey requirements for Section 223(f) & 223(a)(7) projects, see Appendix 5A,
- 10 Survey.
- 11 J. Maximum Time for Completion of Repairs. Appendix 5G and the CNA e Tool require
- 12 that all repairs and alterations be identified as either critical or non-critical. Critical
- 13 repairs are identified as either Life Safety or Accessibility. Those identified as “Life
- 14 Safety” are needed to address hazards to life and health while those identified as
- 15 “Accessibility” are needed to correct accessibility deficiencies. While these are not
- 16 mutually exclusive, only one designation may be applied. All other repairs and
- 17 alterations are non-critical repairs. Life safety repairs must be completed prior to
- 18 Endorsement. Accessibility repairs must be completed as soon as possible and the CNA
- 19 e Tool requires that the time estimated to complete each accessibility repair be identified
- 20 as a number of months. If “as soon as” possible exceeds twelve months for any
- 21 accessibility repair the corrective action plan must be referred to HUD headquarters to
- 22 the attention of the Director of Technical Support in the Office of Multifamily Housing
- 23 Production who will determine whether the proposed corrective action plan can be
- 24 accepted. Non-critical repairs must be promptly and timely executed and completed
- 25 within twelve months of Endorsement, provided that the MF Regional Center/Satellite
- 26 Office Director may approve an extended period not to exceed six additional months for
- 27 unusual circumstances. Repairs and alterations reasonably expected to require more than
- 28 a year to complete should be reconsidered as substantial rehabilitation.
- 29 K. If proposed repairs or alterations require occupancy disruptions or cash flow interruption,
- 30 the lender should estimate such losses by month and add the aggregate total to an
- 31 operating deficit escrow, not the repair escrow.
- 32 L. Funding Repairs, Escrow Agreement for Deferred Repairs (Form HUD-92476.1M) See
- 33 this Form and Chapter 12 Section 12.17.A, for greater detail on these provisions.

- 1 1. The costs of the deferred repairs (including materials, labor, permits, profits, etc., trended to
2 the start of repairs) must be estimated and withheld *in cash* from mortgage proceeds and
3 placed in escrow. A letter of credit may *not* be substituted for this escrow.
- 4 2. An additional cash amount (or letter of credit, at the option of the Lender) of not less
5 than 20 percent of the repair cost estimate will also be placed in escrow as assurance
6 of completion of deferred repairs, provided however, that;
 - 7 a. For 223(a)(7) transactions the additional amount shall be 10% of the repair cost;
8 and,
 - 9 b. The additional deposit may be reduced to 10% of the repair cost for any
10 transaction where a design professional has prepared construction drawings, and
11 the borrower has engaged a non-identity of interest general contractor to execute
12 the work per a form of contract acceptable to HUD that provides for the
13 withholding of retainage in the amount of 10% of the value of work completed as
14 and when payment is requested..
- 15 3. The Lender may release funds from the mortgage proceeds portion of the escrow in
16 proportion of the cost of work completed upon written consent by HUD.
- 17 4. Funds remaining in the escrow may be released when:
 - 18 a. All repairs have been satisfactorily completed as determined by HUD;
 - 19 b. Evidence of clear title has been provided to HUD; and
 - 20 c. The borrower (or the general contractor in cases where a construction contract
21 was executed) has provided latent defect assurances by one of the following:
 - 22 i. An escrow in cash, letter of credit or a surety bond from a surety, at the option
23 of the Lender, equal to 2½% (or a greater percentage as warranted) of the
24 repair cost maintained for fifteen months from completion of repairs to cover
25 situations where the defect is discovered in the twelfth month and additional
26 time is necessary to correct it.
 - 27 ii. A Surety Bond in accordance with Form HUD-3259 from a surety on the
28 accredited list of the U.S. Treasury for at least 2 ½ % of the repair cost, with
29 the bond in effect for two years from the date of completion of repairs. See
30 paragraphs 8 and 9 of HUD-92476.1M for further details.
- 31 5. Funds deposited in the Reserve for Replacement escrow account at or after
32 Endorsement shall not be used for the completion of any repairs and alterations.
- 33 M. Withholding of Excess Proceeds. In cases where completion of repairs is deferred and
34 the mortgage amount exceeds the costs of refinancing and all required costs, including
35 repairs (“cash out transactions”), the Lender shall withhold a percent of the excess

1 proceeds until all repairs and alterations are completed in a manner acceptable to the
2 Lender and HUD. The withheld funds will be added to the repair escrow. The percentage
3 withheld shall be:

- 4 1. 50% of excess proceeds; or
- 5 2. 20% of excess proceeds if a design professional has prepared construction drawings,
6 and a non-identity of interest general contractor has been engaged to execute the work
7 per a form of contract acceptable to HUD that provides for the withholding of
8 retainage in the amount of 10% of the value of work completed.

9 N. Completion of Repairs and Alterations

- 10 1. If the borrower has not completed all repairs by the end of the repair period (including any
11 approved extensions), the Lender will complete the repairs using the escrowed funds and
12 will provide the borrower with a breakdown of these repairs and the cost(s) of completion
13 (including administrative expenses). Funds remaining in the escrow account after
14 completion of the repair work will be returned to the borrower less reasonable
15 administrative costs incurred in completing the repairs.
- 16 2. Requirements after Completion of Repairs. In cases where actual costs are less than
17 estimated, the maximum insurable loan amount must be recalculated. If the maximum
18 insurable mortgage is reduced due to lower actual costs, the borrower must prepay the
19 mortgage:
 - 20 a. In amounts equal to the scheduled monthly principal payments, to the extent possible;
21 with
 - 22 b. Any remainder going to the Reserve for Replacements Fund.

25 **5.11 Cost Estimating for Lenders**

26
27
28 Evaluating the estimates of construction cost prepared by the borrower, design professional,
29 needs assessor or general contractor is a critical element of the Lender's underwriting task. For
30 new construction and substantial rehabilitation projects under Sections 220 and 221(d)(4) and
31 241(a) supplemental loans, replacement cost is one of the criteria used to determine the insured
32 mortgage amount. In value based programs, Section 231 and Section 223(f), replacement cost is
33 a significant consideration in valuation, (although not in existing properties 10 or more years

1 old). Cost estimating consists of estimates of the construction costs for proposed improvements
2 and/or repair and alteration costs for existing improvements at a property.

3
4 A. Method of Estimation.

5 1. New construction and substantial rehabilitation. The method should be similar to that
6 used by general contractors. For new construction and substantial rehabilitation, data
7 should be organized by trade division using the Construction Specification Institute
8 (CSI) Format, and adjusted to reflect cost differences due to time, location, and price
9 fluctuations. (HUD forms reflect the sixteen division CSI format that was replaced in
10 2004 by an expanded, though comparable, format of fifty divisions.) The cost
11 estimate may be prepared using a quantity survey takeoff or a square-foot and per-
12 unit cost approach using established data and making adjustments. Except for gut
13 rehabilitation jobs, costs of repairs and alterations in substantial rehabilitation projects
14 should be developed in the CNA e Tool but should be restated on HUD 92326 so as
15 to compare estimated costs with the general contractor's HUD 2328. By contrast, in
16 gut rehabilitation projects the general contractor's HUD 2328 costs (and/or the
17 construction analyst's HUD 92326 cost) should be developed independently and
18 calculated by building or for each building type, converted to a "per square foot"
19 figure, and entered in the CNA on the Buildings Form.

20
21 2. Repair and Alterations Less than Substantial Rehabilitation. Needs assessors and
22 Lender construction analysts should develop and document costs in the CNA e Tool.

23
24 B. Data. The data source(s) used to prepare cost estimates must be documented. Acceptable
25 cost data may come from completed comparable projects, benchmark amounts taken
26 from actual project costs, and published data from construction cost data publishers. The
27 CNA e Tool requires that replacement cost estimates briefly describe data
28 sources/methods.

29 C. Detailed Cost Estimates. The Lender's construction analyst should use detailed plans and
30 specifications supplied by the design professional and/or the needs assessor in the CNA
31 as a basis for the cost estimate. Estimates must reflect the general level of construction
32 costs in the locality where construction takes place. Costs must be projected to the
33 estimated construction start date. Davis-Bacon labor wage rates must be used for new
34 construction and substantial rehabilitation. It is the Lender's responsibility to obtain
35 current Davis-Bacon wage rates from HUD and to assure that the project design team and

1 general contractor are provided with the relevant and most recent, applicable wage
2 decisions. For new construction and substantial rehabilitation, the cost estimate is
3 tabulated on Form HUD-92326, and totals are reported in Sections G, M, and O of Form
4 HUD-92264.

5 D. Categories of Cost

6 The cost estimate consists of the following items:

7 1. Structures and Land Improvements include:

- 8 a. Dwelling structures. Costs of all residential buildings including footings and
9 foundations.
- 10 b. Garages include all covered parking, from individual carports to complete parking
11 structures. For new construction and substantial rehabilitation, include free-
12 standing garage structures with other accessory buildings on the Accessory
13 Structures line on Form HUD-92326. Garages are reported separately on Line
14 G.39 on Form HUD-92264 except when the garage space is an integral portion of
15 a larger structure; in which case individual trade costs should be reported for the
16 entire structure and not separately for the parking element. Similarly, costs
17 should not be separated when accessory uses or commercial space is included as
18 part of a larger dwelling structure.
- 19 c. For estimates developed in the CNA e Tool, surface parking, including carports
20 are treated as site improvements. In a building designed exclusively for parking
21 (or if parking is a use of space in a larger building with other uses), all enclosed
22 (garage) parking is treated as a common space. Replacement cost is estimated for
23 each building including all the uses of space in the building.
- 24 d. Onsite land improvements make up the following trade line items on Form HUD-
25 92326: Earthwork, Site Utilities, Roads and Walks, Site Improvements, Lawns
26 and Planting, and Unusual Site Conditions. In the CNA e Tool onsite land
27 improvements are identified as the need category “site systems.”
- 28 e. In new construction and sometimes in substantial rehabilitation, unusual land
29 improvements may be required to address conditions not typical to most
30 construction in the locality such as excessive excavation, rock excavation, cuts
31 and fills, special foundations, high water table, problem soils, environmental
32 remediation work or installations, etc. These items are taken from the Unusual
33 Site Conditions trade line item on Form HUD-92326, and are reported separately
34 on Line G.36a of Form HUD-92264. They must be itemized separately because of
35 their possible impact on site value. The Lender’s construction analyst should
36 consult with the Lender underwriter and appraiser to define and quantify the need
37 for unusual site improvements
- 38 f. Short extensions of roads, walks, and utilities from project site boundaries to

- 1 immediately adjacent offsite public improvements are considered onsite land
2 improvements.
- 3 2. Supplemental Cost Estimates include:
- 4 a. Demolition. Demolition is defined as onsite work to remove existing structure,
5 footings, foundations, and utilities to prepare a site for new construction.
- 6 i. Include the removal and disposal of debris and fill and compaction of
7 excavations. Include general contractors' and subcontractor's overhead and
8 profit in the estimate.
- 9 ii. Report on Form HUD-92326, under "demolition," and Form HUD-92264,
10 Section O. Appraiser will report Demolition costs in Section J of Form HUD-
11 92264.
- 12 iii. Demolition should not be included in the construction contract.
- 13 iv. Outside, or site preparation demolition does not include interior demolition
14 within existing structures undergoing substantial rehabilitation.
- 15 b. Offsite work is work not immediately adjacent to project boundaries including
16 utilities, walks, curbs, gutters, streets, drainage structures, landscaping, etc., that
17 extend away from the project site. These improvements are not included in the
18 construction contract. Report on Form HUD-92326 and Section M of Form
19 HUD-92264.
- 20 3. Cost Not Attributable to Dwelling Use. Cost not attributable consists of certain
21 project amenities and uses other than dwelling uses. This cost is calculated by the
22 cost analyst and used by the appraiser to increase the maximum mortgage amount
23 under Criterion 4 of Form HUD-92264-A (Statutory maximum insurable mortgage
24 amount per dwelling unit). The calculation is material only when project costs are
25 likely to exceed the statutory limit and when a portion of those costs are not
26 attributable to dwelling units. (Criteria 4 is typically not material and need not be
27 calculated except for properties in major cities with the maximum high cost factor
28 adjustment of 270%). These costs must be included within the estimate of total
29 structures and land improvements; also the costs must be itemized and reported
30 separately on Form HUD-92326 and Section M of Form HUD-92264. The basic
31 theory of estimating cost not attributable is to isolate construction costs for: (A) all
32 improvements and for (B) selected improvements not related to or necessary for the
33 dwellings (non-residential use). In each case the total is without general requirements
34 and fees. The percentage of B divided by A is the percentage of costs not
35 attributable. Such a percentage should be calculated for both residential
36 buildings/spaces and commercial buildings/spaces, neither of which figures may
37 exceed a fixed maximum of 15%. The two are added together to obtain the project
38 percentage of cost not attributable. This figure is used to allocate a proportionate

- 1 share of all other mortgageable costs (fees, construction period interest and finance
2 charges, land, etc.) between dwelling use and costs not attributable to dwelling use.
3 The total of all costs not attributable times the maximum percentage loan to cost ratio
4 is added to the maximum statutory limit calculated for the number of units by type.
5 The sum is the maximum mortgage amount per Criteria 4. (See Appendix 5J)
6
- 7 4. Allowances and Fees are reported on Forms HUD-92326 and HUD-92264 as lump
8 sum dollar amounts. Depending upon data, they may be calculated either as lump
9 sums, or as percentages of subtotals which are converted to dollar amounts.
- 10 a. General Requirements (Job Overhead). Covers project specific overhead
11 expenses. Calculate as a percentage of the sum of Total Land Improvements and
12 Total Structures. The percentage amount is determined by the nature, difficulty,
13 size of the project, and the characteristics of the neighborhood.
- 14 i. Include:
- 15 (a) Supervision and job-site engineering;
- 16 (b) On-site job office expenses directly related to the project including clerical
17 wages;
- 18 (c) Temporary buildings, tool sheds, shops, and toilets,
- 19 (d) Temporary heat, water, light and power for construction;
- 20 (e) Temporary walkways, fences, roads, siding and docking facilities,
21 sidewalk and street rental;
- 22 (f) Construction equipment rental not included in trade item costs;
- 23 (g) Cleanup and disposal of construction debris;
- 24 (h) Medical and first aid supplies and temporary facilities;
- 25 (i) Security guard wages and related costs;
- 26 (j) Theft and vandalism insurance. (does not include Builders Risk
27 Insurance).
- 28 (k) Builders Risk Insurance may be included with general Requirements or
29 Contractor's other fees (only if paid for by General Contractor).

- 1 Builders Risk Insurance is separate from any theft and vandalism
2 insurance policy provided by the general contractor. While Builders Risk
3 Insurance may be placed by either the general contractor or the Borrower,
4 it is common industry practice for the contractor to place the policy, with
5 the contractor named as Insured, and the Borrower named as “Other
6 Insured.” Regardless of which party is responsible for payment, the
7 Borrower must always be named as an Insured party, as per Builder’s Risk
8 Insurance requirements in Form HUD-92447, Property Insurance
9 Requirements. If the contractor pays for the policy, the premium is
10 included in the construction contract under General Requirements.
11 However, if the Borrower pays for the policy, the insurance premium is
12 included under Insurance on Line G-55, Insurance, of Form HUD-92264.
- 13 ii. Salaries for site visits by owners, partners, or officers of the general
14 contracting firm are included in General Overhead. The only exception is
15 actual work done on the job by these individuals in a trade capacity, as
16 laborers or supervisors.
- 17 b. General Overhead. Covers contractor’s home or principal office and general
18 business expenses. The amount is fixed at two percent of the sum of Total Land
19 Improvements, Total Structures, and General Requirements.
- 20 c. Builder’s Profit. Builder’s profit is calculated as a percentage of the sum of Total
21 Land Improvements, Total Structures, and General Requirements. The
22 percentage amount is determined by the nature and location of the project and
23 market conditions, and should be compared to the amount of the fee negotiated
24 between the borrower and contractor for reasonableness. When the general
25 contractor is an independent third party (no identity of interest with the borrower
26 or sponsor) the Builder’s Profit or Fee is an actual cost that must be paid to the
27 general contractor. This applies to all non-identity of interest general contractors
28 participating in any of HUD’s mortgage insurance programs. When the general
29 contractor has an identity of interest with the borrower, see paragraphs “d” and
30 “e” below.
- 31 d. Builder Profit in Value Based Programs-Section 231 and 223(f). Builder or
32 general contractor profit or fee or development fees payable to affiliates of the
33 borrower, i.e., identity of interest participants, are not mortgageable costs and
34 should not be included in the cost estimate.
- 35 e. BSPRA. Builder’s and Sponsor’s Profit and Risk Allowance (BSPRA) is a
36 presumed profit for development and construction of a multifamily project and is
37 unique to applications for new construction or substantial rehabilitation under
38 HUD’s “cost based” programs (Sections 220 and 221(d)(4)) and 241(a)) when an

1 identity of interest exists between the borrower and the general contractor.
2 BSPRA is always 10% of replacement cost not including land, but is itself not an
3 actual cost or fee that will actually be paid to the identity of interest general
4 contractor and/or development entity (sponsor). It is used to calculate the
5 mortgage amount based on a percentage of replacement cost (Criteria 3 on the
6 HUD 92264-A). Its effect is to allow the identity of interest
7 borrower/developer/contractor to contribute its presumed builder/developer profit
8 (BSPRA) as equity whenever the mortgage amount is limited by Criteria 3. In a
9 balanced summation of sources (loan proceeds, equity, etc.) and uses (costs of
10 land, development, construction, capitalized interest, etc.) this presumed profit or
11 BSPRA is added both to uses and sources. When Criteria 3 prevails, the
12 mortgage amount will be a fixed percentage of costs. The “B” in BSPRA refers to
13 the presumed fee of the builder or general contractor. The “S” refers to
14 development cost of the sponsor/borrower outside the general contract and is
15 called SPRA. The appraiser calculates the BSPRA amount and enters it on line G
16 68 of Form HUD-92264. Where BSPRA applies, the lender should:

- 17 i. Calculate an equivalent builder’s profit (the “B” portion of BSPRA) and an
18 equivalent subtotal.
- 19 ii. On the Builder’s Profit line of Form HUD-92326 and on Line G 44 of Form
20 HUD-92264, enter the word “BSPRA”. The equivalent builder’s profit
21 calculated above is not included in the Total for All Improvements (bottom of
22 Form HUD-92326 and Line G.50 of Form HUD-92264).
- 23 f. Architect’s Fees. The source of this cost is the Owner-Architect Agreement,
24 (see Section 5.3.C). If there are multiple prime agreements (e.g. separate
25 architect and engineer), total all fees in line G 45 of HUD-92264 and itemize
26 in Section O, Remarks. The construction analyst should copy the fee
27 amounts, unaltered, to the cost estimate. The construction analyst should
28 document architect’s fees and compare with existing fee data to determine
29 reasonableness. The construction analyst should inform the Lender
30 Underwriter if fees are significantly different from the data range, but the fees
31 should not be altered on the cost estimate without a prior meeting between the
32 Lender, Lender’s construction analyst, borrower, and project Architect. Fees
33 should be documented as a percentage of the sum of Total Land
34 Improvements, Total Structures, General Requirements, General Overhead,
35 and Builder’s Profit. The Architect’s Fee usually consist of a design fee
36 which offsets the cost of the preparation of all construction documents

- 1 (working drawings and specifications) up to start of construction, and
2 typically represents 75 to 80 percent of the total fee. The Architectural
3 Supervision fee offsets the cost of the Architect's construction inspections,
4 reports, and preparation of change order requests, and typically represents 20
5 to 25% of the total fee.
- 6 g. Bond Premium. Offsets the cost of Payment/Performance Bonds used to ensure
7 completion of construction in event of a default by the general contractor. The
8 bonding or surety company determines the premium or cost based on its
9 perception of risk in light of the contractor's financial capacity and performance
10 history and the nature of the work.
- 11 h. Other Fees. Costs of various required items and services, which can vary greatly
12 among jurisdictions and localities.. Other fees can be paid either by the borrower
13 or the general contractor. The borrower should submit an itemized list of all
14 project related other fees as an aid to the construction analyst. Other Fees can
15 include:
- 16 i. Site and topographic surveys;
17 ii. Subsurface exploration (test borings);
18 iii. Soil tests, concrete tests, and other construction testing;
19 iii. Fees for utility taps and connections;
20 iv. Impact fees for public infrastructure;
21 v. Building permits and licenses; and
22 vi. General Contractor's cost certification audit fee (if required). NOTE: The
23 borrower's cost certification audit fee is not to be included in Other Fees since
24 it is recorded separately on Line G. 66 of Form HUD-92264.
25 vii. Builders Risk Insurance may be included with general Requirements or
26 Contractor's other fees (only if paid for by General Contractor).
- 27 i. Furniture, Fixtures, and Equipment (FF&E) includes substantial indoor and
28 outdoor furniture and equipment. It may not include titled vehicles, minor items
29 of relatively insignificant cost such as furniture accessories, income from rental
30 unit furnishings, hand tools and hand power tools, or expendable items. An
31 itemized schedule of FF&E with cost for each item will be submitted with the cost
32 documents and reviewed by the Lender's cost analyst for acceptability. Costs
33 may include only delivery and placement of the item. The dollar amount of FF&E
34 will be reported on line G.60 of the HUD-92264; "AMPO percent (nonprofit
35 only)" will be lined out and substituted with "FF&E".

1 submitted in final form based on the final drawings and specifications no later than 30 days prior
2 to Initial Endorsement.

3 A. Required Forms

4 1. Form HUD-92326. Used for preparation of detailed construction cost estimate for
5 new construction and substantial rehabilitation projects.

6 2. Form HUD-92331-B. Used to make detailed comparison of trade line items between
7 Estimators' cost estimate (HUD-92326) and Contractor's trade payment breakdown
8 (HUD-2328) for new construction and substantial rehabilitation projects.

9 3. Form HUD-92329. Property Insurance Schedule, used to determine the Maximum
10 Insurable Value for all project structures and for all applications. Form HUD-92447,
11 Property Insurance Requirements, will be prepared by HUD and provided to the
12 Lender at closing.

13 4. Form HUD-92264. Project Income Analysis and Appraisal.

14 a. Section G. Estimated Replacement Cost, Line 36a through 52 is used to
15 summarize Total Structures, Land Improvements, General Requirements, and
16 Fees from Form HUD-92326, and also records estimated construction time. This
17 section is primarily used for substantial rehabilitation and new construction.

18 b. Section M. Used to summarize Cost Not Attributable to Dwelling Use (lines 10
19 through 15), and Offsite Requirements (lines 16 and 17).

20 c. Section O, Remarks. Used to explain Unusual Land Improvements, Other Fees,
21 itemization of professional fees (e.g. engineers), overall difference between
22 Lender's and borrower's cost estimates, and other cost items.

23 B. Prepare detailed cost estimate on Form HUD-92326 using instructions in Section 5.11;
24 sign form on the "Estimate Prepared by" line and certify. Refer to standard certification
25 in Chapter 11, Section 11.2.

26 C. Resolve differences in Lender's and contractor's construction cost estimates.

27 Before the Firm Commitment application can be submitted for HUD review, the
28 construction cost estimates prepared by the general contractor and the Lender's
29 construction analyst must be reconciled. The Lender's analyst is responsible for
30 resolving major differences between the two estimates. When the two estimates are
31 generally consistent, the Lender may use the contractor's cost figures as shown on Form
32 HUD-2328 as its cost estimate. The Lender's construction analyst will use the following
33 review procedure for new construction and substantial rehabilitation applications:

34 1. Prepare trade line item comparison of Lender's and contractor's cost estimates using
35 Form HUD-92331-B.

- 1 a. Enter costs from Forms HUD-92326 and HUD-2328. For multiple-structure type
2 projects, a separate HUD-2328 must be submitted for each structure type, and a
3 master HUD-2328 for the entire project.
- 4 b. Calculate and list line item percentage differences.
- 5 2. Review trade line item differences and note all variations beyond normal ranges. The
6 range of trade line item differences varies from trade to trade. Major trades (e.g.
7 engineers, carpentry) should have a smaller range difference than minor trades (e.g.
8 sheet metal). The estimator should judge the variations based on established data.
9 Front-end Loading: The estimator should be alert for a pattern of front-end loading in
10 trade items, where the contractor inflates costs for trade items needed early in the job
11 schedule in order to secure more mortgage proceeds early. Such a pattern may
12 indicate inadequate working capital or risky business practices by the contractor.
13 Advances of funds from loan proceeds should always accurately reflect the cost of
14 work completed and payment should follow, never precede, the completion of work
15 or portions thereof for which payment is requested.
- 16 3. Meet with contractor to discuss and resolve all questionable trade line item
17 differences. The resolution process may result in either the estimator or the
18 contractor, or both, recalculating costs of various trade line items based on
19 discussions.
- 20 a. If differences are resolved, accept costs in Form HUD-2328 and use as Lender's
21 Cost Estimate in Form HUD-92264.
- 22 b. When dealing with suspected front-end loading, require rigorous documentation
23 of early trade items that are higher than normal.
- 24 c. If differences cannot be resolved, do not accept costs in Form HUD-2328.
 - 25 i. Use construction analyst's cost estimate as Lender's cost estimate.
 - 26 ii. Inform the Lender's underwriter that the contractor's HUD-2328 is
27 unacceptable.
 - 28 iii. Advise the Lender's underwriter to meet with the borrower and the
29 contractor for further attempts at resolution.
- 30 D. Prepare cost portions of Form HUD-92264, using instructions in Section 5.11. Sign form
31 in the "Cost Processor" box and certify (see standard certification in Chapter 11, Section
32 11.2).
- 33 E. Property insurance schedule, Form HUD-92329, based on CNA e Tool replacement cost
34 per building. Common equipment that serves the entire property or portions thereof (e.g.

- 1 a boiler and cooling tower assembly) should be included with the cost of the building
2 where it is located and not prorated among the buildings served by the equipment.
- 3 F. Prior approval of identity of interest subcontractors' proposed costs including overhead
4 and profit is required.
- 5 1. An Identity of Interest is a relationship that exists giving the borrower or general
6 contractor apparent control or influence over a subcontractor, equipment lessor,
7 material supplier, or manufacturer of industrialized housing. (See General
8 Contractor's cost certification instructions in Chapter 13 - Cost Certification, for
9 definition of relationships).
- 10 2. Requirements. When subcontractors, material suppliers, or equipment lessors have an
11 identity of interest with a borrower or general contractor, the Lender must approve the
12 subcontract amounts, including specific amounts for subcontractor general overhead and
13 profit.
- 14 3. Timing. Approval is required before work begins under the subcontract. Failure to
15 secure prior approval will result in the disallowance of the total general overhead and
16 profit of the subcontractor at cost certification.
- 17 4. Request for approval (with the subcontracts, agreements, or leases) is submitted to the
18 Lender's construction analyst, whose recommendations must include:
- 19 a. Acceptability of the documents.
20 b. Reasonableness of guaranteed maximum prices for the subcontract work.
21 c. Appropriateness of general overhead and profit dollar amounts.
- 22 5. Mandatory Conditions for Approval.
- 23 a. Subcontracts:
- 24 (1) Must be a separate subcontract for each trade.
25 (2) Must clearly identify scope of work.
26 (3) Must be on a cost plus fixed fee basis:
27 (a) Guaranteed maximum dollar amount for work.
28 (b) Specific dollar amount for general overhead and profit.
- 29 (4) Disapprove "paper conduit" arrangements where work is to be done by
30 general contractor personnel or other subcontractors, suppliers or lessors.
- 31 b. Subcontract prices: For this criterion, recent reliable data is a better test than
32 whether higher bids were submitted.

- 1 (1) The total price must not exceed the amount shown for the trade item on
2 the accepted Form HUD-2328.
- 3 (2) Total price must not exceed reasonable prices taken from available data.
4 NOTE: The Lender's cost analyst must resolve disagreements in trade
5 prices with the subcontractor.
- 6 c. Overhead and Profit. The amounts for general overhead and profit shall be no
7 higher than the typical prices for the specific trade.
- 8 d. Subcontractor entity. The burden of proof of 1, 2, and 3 below is on the
9 subcontractor.
- 10 (1) The firm must operate and have documented experience as a subcontractor
11 for the specific field covered in the subcontract.
- 12 (2) Must control labor, materials, and equipment typical for the trade.
- 13 (3) Must do significant business in its specific field with borrowers and
14 general contractors having no identity of interest.
- 15 6. If total of all identity of interest subcontracts, purchases and leases is less than 1/2 of 1
16 percent of the mortgage amount, the requirements for each identity of interest
17 subcontractor to cost certify may be waived by the MF Regional Center/Satellite office
18 Director upon notification by the Lender.
- 19 7. Prepare letter of approval or disapproval to the borrower or general contractor. Letter
20 must address all mandatory conditions.
- 21 a. Approval will indicate any conditions, including whether or not subcontractor must
22 cost certify.
- 23 b. Disapproval will state the reason for disapproval and indicate any cost
24 certification requirements.

25 G. Cost Concerns for Substantial Rehabilitation

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The detailed cost estimate should include and evaluate the following:

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1. Interior demolition and removal of floors, walls, roofs, doors and windows, finishes, cabinets, appliances, plumbing, HVAC, and electrical, including boilers and central air conditioning. Also includes abatement of asbestos and lead based paint. Enter amount in Special Construction trade line in Form HUD-92326. If individual trades

- 1 include removal (e.g. remove and replace cabinets), removal costs may be included in
2 the trade line item.
- 3 2. Site preparation demolition is not part of the Construction Contract and should be
4 estimated and recorded in the same way as for new construction.
- 5 3. Allowances and Fees for substantial rehabilitation, especially General Requirements
6 and Architect's Fees, are calculated the same way as for new construction, but they
7 should reflect the risk and responsibility inherent in rehabilitation and consider the
8 location of the project. It is recommended that the cost estimator keep separate data
9 for this item.
- 10 4. Rehabilitation time is determined the same way as construction time for new
11 construction, but the data used must take into account the time required for interior
12 demolition, as repair and rehabilitation cannot begin until such demolition is
13 complete.
- 14 5. Rehabilitation cost not attributable to dwelling use includes an "as-is" value for non-
15 attributable items in addition to a value for actual work performed. Calculate by using
16 the format in the Appendix 5J.2. The cost analyst completes steps 1, 2, and 3; steps 4
17 through 8 are completed by the appraiser.
- 18 6. Contingency reserve amount is based on available data for the type and condition of
19 structure. Calculate as percentage of the sum of structures, land improvements, and
20 general requirements. Percentage ranges from 10 to 15%, depending on the condition
21 of the project, extent of rehabilitation, and experience and financial capacity of the
22 borrower and contractor. Enter amount on line G.71 and in Section O of Form HUD-
23 92264. Subject to Lender and HUD approval, the Borrower may elect to apply any
24 funds remaining in the substantial rehabilitation construction contingency account
25 after completion of the approved rehabilitation, to:
 - 26 a. further improvements, betterments or upgrades to the property,
 - 27 b. an initial deposit to the Reserve for Replacement account; or
 - 28 c. reducing the mortgage balance.
- 29 If excess funds from contingency are used for betterments, those additional
30 improvements will not be considered as the basis for a request for an increased
31 mortgage amount.

32

33 H. Cost Concerns for Refinance/Acquisition-Section 223(f) and 223(a)(7)

34

- 35 1. The lenders construction analyst must determine that:

- a. The CNA accurately describes, quantifies and estimates immediate repairs and future needs and that replacement costs data sources are identified;
 - b. The assessed remaining useful lives of components and estimated useful lives for alternatives are justified whenever the entered values depart from the Standard Estimated Useful Life Table;
 - c. The flags obtained from validation of the needs assessment via the Validation Engine of the CNA e Tool are either removed by amending the needs assessment or explained in a flag comment.
2. The cost portions of HUD 92264 should be completed based on the replacement cost of buildings as reported in the CNA e Tool.
 3. The construction analyst must review the needs assessor's "Repair, Replace Add New Recommendations" and determine that life safety and accessibility repairs have been identified with a "yes" in the appropriate indicator, and that the recommended timing, cost and other action are appropriate and consistent with observed conditions.
 4. The Lenders construction analyst should review any immediate repairs for 223(a)(7) applications to assure that repairs are limited and do not exceed routine maintenance, except for needed remedies for accessibility deficiencies.

5.13 HUD Procedures

All applications will be assigned to a Senior Underwriter or underwriting team by the Production Chief. The underwriting team will complete an early warning system (EWS) review of each application and identify which applications can be assigned to and reviewed by a single underwriter and which may require the assistance of the Technical Branch Chief and/or a HUD construction analyst (architect, cost analyst). In general all new construction and substantial rehabilitation applications should be reviewed by a construction analyst. In addition, refinance and acquisition applications with combinations of repairs and alterations exceeding \$15,000 per unit in cost and/or include Level 2 and Level 3 Alterations should be reviewed by a HUD construction analyst. Applications for Section 223(f) for properties less than 10 years old and for Section 223(a)(7) should not require the assistance of a construction analyst unless the CNA contains a corrective action plan for accessibility deficiencies or the underwriter observes that such a plan is required but not submitted. Section 223(f) applications for properties older than 10 years with repairs and Level 1 Alterations will require the underwriter to determine whether any issues are observed that might require a technical review.

-
- 1 A. When engaged to complete a technical review or consider a particular lender exhibit, the
2 HUD construction analyst should not redo or correct the Lender’s work. Instead the
3 review should be summarized in writing for the HUD underwriter.
- 4 1. Review the Lender deliverables for completeness;
- 5 2. Examine the review report and the A/E and cost exhibits and recommend either
6 acceptance or rejection of the A/E and cost portion of the Firm Commitment
7 submission and report to the underwriter on the form(s) at Appendix 5F and
8 following as appropriate for the application stage and program
- 9 B. Any application for an existing property proposing repairs and alterations in any
10 combination that results in uncertainty about program eligibility (refinance/acquisition vs.
11 substantial rehabilitation) should be reviewed by the HUD construction analyst who shall
12 review the immediate repairs identified in the CNA e Tool.
- 13 1. The costs of all repairs should be totaled and compared to the cost per unit threshold
14 (5.2.D) adjusted for the applicable high cost factor. If the total cost of immediate
15 repairs exceeds the threshold, the application is for substantial rehabilitation.
- 16 2. All the immediate repairs should be sorted by “Need Category and Need Item so as to
17 establish cost by system (5.2.B) and the cost by system compared to the estimated
18 replacement cost for the entire system as configured at the property. If two or more
19 of the systems exceed 50% replacement measured by cost, then the application is
20 substantial rehabilitation.
- 21 C. The CNA e Tool reviewer assigned to the application must approve the final Capital
22 Needs Assessment but should not do so until the underwriter, senior underwriter or
23 Production Chief has concurred and the financial plan (initial and annual deposits) and
24 immediate repairs are final.
- 25 D. Timely consultation and review by other HUD staff may expedite applications and avoid
26 delays at closing. In particular, survey issues, proposed easements and joint use and
27 access agreements that impact design, construction or operating expense estimates should
28 be reviewed by Regional Counsel before final underwriting is completed.
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Chapter 6 Formerly Cost

This chapter has been combined with Chapter 5 and is reserved for use in future MAP Guide revisions.

DRAFT

Chapter 7 Valuation Analysis & Market Analyst

7.1 Introduction

A. This chapter provides guidance on HUD's Valuation and Market Study requirements for all HUD personnel involved in reviewing appraisals, including Third-Party MAP Appraisers and MAP Lenders and Underwriters

B. The Valuation Analysis evaluates the existing or proposed project as collateral and security for a long-term mortgage. Depending on program requirements, this includes an estimation of the market value of the land and/or the property and an analysis of the market need, location, residential and commercial rent and other income, and operating expenses of the project.

The Valuation Analysis develops conclusions with respect to feasibility, suitability of improvements, extent, quality, and duration of earning capacity and other factors that have a bearing on the economic soundness of the project. The objective of the appraisal is to establish value for use in underwriting the supportable loan amount and to determine if the project will meet the market demand at rents that will pay operating expenses, debt service and provide for sufficient deposits to any reserve accounts.

C. The Department has statutory authority (12 USC 1708(g)) to prescribe standards for the appraisal of all projects to be insured by the Federal Housing Administration. Such appraisals shall be performed in accordance with uniform standards, by individuals who have demonstrated competence and whose professional conduct is subject to effective supervision. Under the MAP Program, HUD relies on the MAP Approved Lender to provide such supervision. Additionally, the Department requires a USPAP Compliant appraisal review by a HUD Review Appraiser (HRA) for medium to high risk transactions.

D. The Multifamily Regional Center Director has authority to rely on the lender's appraisal review without a HUD staff appraiser review. Exercise of such authority may be appropriate

1 for low-risk and some medium-risk transactions in which the application is complete and
2 reliable. In all cases, a qualified HUD employee must review each appraisal for compliance
3 with USPAP and HUD requirements.

4 **7.2 Selection of Appraisers and Market Analysts**

5 A. The lender is responsible for the selection and approval of appraisers and market analysts
6 who are familiar with MAP guidelines. Lenders must ensure that each appraiser and market
7 analyst selected is qualified to appraise or perform market analyses for multifamily properties
8 by reviewing their education, quality, and frequency of multifamily appraisal experience,
9 sample appraisals and market studies, professional affiliations, and state licenses or
10 certifications. The ability to complete various HUD forms related to the appraisal, i.e. HUD-
11 92264, 92273, 92274 etc., is also a requirement. The lender may assist the appraiser in the
12 preparation of these forms, and the appraiser must sign them. The HUD 92264-A is an
13 underwriting form prepared by the MAP underwriter. It is not a required appraisal exhibit.

14 B. Should the lender have difficulty finding a Certified General Appraiser, the Appraisal
15 Subcommittee of the Federal Financial Institutions Examination Council maintains a
16 national registry of Certified General Appraisers who are authorized, under Federal law,
17 to perform appraisals in connection with federally related transactions. The lender may
18 review this list at <http://www.asc.gov>, although inclusion on this list is not an indication
19 of competency to perform multifamily appraisals.

20 C. The appraiser or the market analyst must be independent of and may not be affiliated
21 with the loan originator, broker, developer, borrower, MAP Lender or any individual or
22 institution involved in any other financial role in the application. The underwriter shall
23 not act as the appraiser or market analyst.

24 D. The third-party appraiser must be selected and overseen by the MAP Lender's underwriter.
25 The appraisal must be ordered and paid for by the lender's underwriter and not by the
26 originator, broker, developer or borrower. The appraisal must identify HUD as an
27 intended user of the report. Appraisals prepared by an affiliate, or not engaged or paid
28 for by the lender, are not acceptable and will not meet HUD's appraisal requirements.

29 E. The market study should be ordered and paid for by the lender. However, a market study

1 that has been prepared for the borrower by a third party market analyst and meets all
2 other market study requirements of the Guide, including timeliness, is acceptable. The
3 lender is responsible for the review and acceptance of all market studies submitted with
4 the application.

5 F. There shall be no discrimination on the basis of race, color, national origin, religion, sex,
6 age, or disability in the selection of an appraiser or market analyst.

7 G. HUD reserves the right to examine the credentials of all appraisers and market analysts hired
8 by the lender, and to reject any individuals that it considers unqualified. HUD staff with
9 concerns about a third party's capability, competence or experience should contact the
10 Multifamily Asset and Counterparty Oversight Division (MACOD) through their
11 supervisory chain. HUD does not formally approve appraisers or appraisal firms as being
12 "MAP Approved." Rather, the MAP Lender is responsible for ensuring the professionalism
13 and competence of its contracted appraiser and the quality of the ultimate appraisal product
14 submitted as a component of the lender's application.

15 **Note: HUD will not reject any third-party contractor without having first issued warning**
16 **letters to the lender highlighting the areas of non-compliance in their submitted reports.**
17 **Third-party contractors will be afforded the right of appeal and due process in**
18 **defending their work, consistent with Asset Management Counterparty Oversight**
19 **Division (AMCOD) procedures.**

20 H. The most current appraiser Certification required by Uniform Standards of Professional
21 Appraisal Practice (USPAP) must be signed by the appraiser. In addition, the appraiser
22 must include a certification that the racial/ethnic composition of the neighborhood
23 surrounding the project in no way affected the appraisal determination.

24 25 **7.3 Third Party Appraiser and Market Analyst** 26 **Qualifications**

27 **A. Appraiser Qualifications**

- 28 1. Each appraiser must meet the following minimum qualification requirements:
- 29 a. Be a Certified General Appraiser under the appraiser certification requirements
30 of the state in which the subject project is located;

- 1 b. Be currently active and regularly engaged in the appraisal of multifamily
2 properties;
- 3 c. Meet all requirements of the Competency Rule described in USPAP, which
4 applies to each certified appraiser who signs the report. If any of the persons
5 involved in preparing the report is a trainee acting as an assistant, this must be
6 disclosed in the report;
- 7 d. Have at least three years of income project appraisal experience;
- 8 e. Be knowledgeable concerning current real estate market conditions and financing
9 trends in the geographic market area where the subject project is located, and be
10 experienced in appraising multifamily properties with the complexity and
11 characteristics similar to those of the subject project. If the subject contains
12 commercial space, Low Income Housing Tax Credit (LIHTC) or other subsidies,
13 the appraiser must have acceptable prior experience in the appraisal of
14 comparable properties.

15 These requirements apply to each Certified General Appraiser signing the report. It
16 is not permissible for an appraiser who is not certified in the appropriate jurisdiction
17 to circumvent certification requirements by having a locally certified appraiser co-
18 sign the report. Appraisers who are not certified in the appropriate jurisdiction may
19 not perform the required project inspections of the subject or comparable properties.
20 The appraiser must disclose any of the persons involved in preparing the report who
21 are not certified general appraisers and are acting as an analyst, assistant or trainee.

22 2 Temporary Certification. Temporary certifications are permissible; however, the above
23 competency requirements still apply. The appraiser is responsible for checking the
24 accuracy of all information obtained from local sources and must indicate the
25 names of all individuals who provided material assistance in preparing the
26 appraisal. A temporary certification must be obtained prior to beginning the
27 assignment. The lender may select appraisers who have temporary certification
28 who have documented how they will achieve competence in the subject area in
29 accordance with USPAP.

30 B. Market Analyst Qualifications

- 31 1. Each Market Analyst must meet the following minimum qualification
32 requirements:
 - 33 a Have at least 3 years of experience in performing market analysis for income
34 producing properties,
 - 35 b Be currently active and regularly engaged in performing market studies for
36 multifamily properties,

- 1 c Be knowledgeable concerning real estate market conditions and financing trends
2 in the geographic market area where the project is located, and
3 d Be experienced in performing market studies for multifamily properties with the
4 complexity and characteristics similar to those of the subject project. If the
5 subject contains commercial space, LIHTC or other subsidies, the market analyst
6 must have acceptable prior experience with comparable properties.
- 7 C. If the Hub/PC believes that a lender is contracting unqualified or unlicensed appraisers or
8 market analysts, the PC must refer the case to MACOD for investigation.

9 **7.4 Market Study Applicability and Requirements**

- 10 A. Applicability. When a separate market study is required, the appraisal and market study
11 should be completed by different firms or different individuals specializing in these
12 separate functions. A separate market study and appraisal is required for all new
13 construction properties and all substantial rehabilitation projects with significant resident
14 displacement, resulting in negative cash flow during the rehabilitation period and for all
15 LIHTC transactions without either a material rent advantage or project based rental
16 assistance for 90% of the units. The Hub or Regional Center Director can waive this
17 requirement on a case-by-case basis, if it is clear the appraiser or appraisal firm has
18 unique experience and knowledge of the market area's supply and demand, is capable of
19 performing both the subject appraisal and the macro market analysis, and if it can be
20 demonstrated that the condition of the market is stable. Section 223(f) proposals
21 typically do not require a market study separate from that contained in the appraisal.
22 However, in volatile or declining markets, the lender should consider, and HUD may
23 require a market study to support the underwriting conclusions of market demand for the
24 subject project over the loan term. Market studies are not required for properties with at
25 least 90% of the units covered by a long term (5 years or more) rental assistance contract
26 and with any rent increase confirmed before initial or final endorsement.

27
28 The MAP Underwriter must reconcile any significant differences between the appraisal
29 and market study in the underwriting narrative.

- 30 B. Requirements. Each market study must meet the following requirements:
31 1. Meet the requirements of Section 7.5.
32 2. Meet the content and format requirements of Section 7.5.

- 1 3. Effective Date. For pre-applications, the effective date of the study must be within
2 120 days before the date of the pre-application package. For Firm Commitments, the
3 effective date of the study must be within 180 days prior to the issuance, re-issuance
4 or amendment of the Firm Commitment. Expired reports must be updated as needed
5 by re-surveying all relevant data. In cases where firm commitments are delayed and
6 the market has remained stable, HUD may, at its discretion, consider waivers to allow
7 the lender's underwriter to resurvey the data and provide updated market study
8 information.
- 9 4. Have the information from the lender listed in Appendix 4.
- 10 5. Be prepared in conformance with the market study format in Section 7.5.
- 11 6. In cases where a waiver is granted and the appraiser prepares the market study, it must
12 be submitted as an independent exhibit and separately bound report.
- 13 7. Include the market analyst's certification per the format in Chapter 11.

14 **7.5 Content and Format of the Market Study**

15 *[numeration in this section will be corrected. Identify feedback by page and line*
16 *number please.]*

- 17
- 18 A. Purpose and focus of the study. The purpose of the market study is to assure that
19 there is enough sustainable demand for additional units without adversely impacting
20 the existing supply, so as to maintain a balanced overall market. The focus of the
21 market study is on the overall demand within a defined market area, and of the
22 proposed project's ability to capture and sustain a share of the total or incremental
23 demand. The primary and secondary market areas analyzed by the lender's market
24 analyst may be narrower in scope than the market analysis prepared by the HUD
25 Economic and Market Analysis Division (EMAD), which analyzes the broader
26 Metropolitan Statistical Area (MSA), county, or smaller submarket area as
27 appropriate. The market analyst must, however, also discuss the larger MSA or
28 county. The study must estimate the number of renter households with sufficient
29 incomes to afford the type of housing at the rents proposed, at present, as well as any
30 expected changes in rental housing demand in the foreseeable future (typically the
31 next 3 to 5 years). The study must also identify and discuss any risks associated with
32 longer-term changes in rental housing demand (during the amortization period of the
33 mortgage). In addition, the study must estimate the number of units that the market
34 could reasonably absorb over a specified forecast period, which is typically 3 years,
35 taking into consideration competitive units in the existing inventory, units currently

- 1 under construction, and units in the planning pipeline, as well as the gross and
2 contract rents of those units.
- 3 For projects designed for the elderly, age 62 and over, the study must estimate the
4 number of elderly households with sufficient incomes to afford the type of housing and
5 services under study, any expected change in the number of such households, the
6 proportion of those households that would need and demand such housing, and the
7 number of units that the market could reasonably absorb and sustain over the forecast
8 period. Useful information may be obtained from the Form HUD-92013, “Supplemental
9 Application and Processing Form Housing for the Elderly/Disabled”, or alternate format
10 provided by the lender. (See subpart I below)
- 11
- 12 B. Executive Summary. All market studies must contain an Executive Summary with a
13 concise summary of the data, analyses and conclusions, including the following:
- 14
- 15 1. a description of the site and the immediate surrounding area;
 - 16
 - 17 2. a summary of the project, including the proposed targeted population;
 - 18
 - 19 3. a statement of key conclusions reached by the analyst; including but not limited to the
20 forecast average annual change in the number of households for a specified period of
21 time.
 - 22
 - 23 4. a statement of the analyst's opinion of market feasibility, as determined by factors of
24 market demand;
 - 25
 - 26 5. recommendations and/or suggested modifications to the proposed project, if
27 appropriate;
 - 28
 - 29 6. a summary of competitive advantages and disadvantages, and issues that will affect
30 the project's marketability, performance and lease-up, as well as points that will
31 mitigate or reduce any negative attributes.
 - 32
 - 33 7. The number of units currently under construction and in the development pipeline.
 - 34

1
2
3 C. Description of the proposed project. The market study must include a thorough
4 description of the proposed project, including:

5
6 1. The number of units by type and size with information on the number of
7 bedrooms and bathrooms, structure type, square footage, etc. Actual
8 (paint to paint) size should be noted as well as the size in published
9 brochures or other media.

10
11 2. The proposed market rents, contract and gross rents by unit type. (Gross
12 rent is defined as the cost of renting the unit, including the cost of resident
13 paid utilities.)

14
15 3. Estimate of utility expenses to be paid by the tenant.

16
17 4. The unit features, project amenities and services and associated cost.

18
19 5. Identify and analyze any project-based rental subsidies to be offered,
20 specify the number of subsidized units, the type and form of the
21 assistance; and rent levels related to market rents.

22
23 6. The project location in terms of:

24
25 a. Characteristics of the neighborhood in relation to schools, transportation,
26 shopping, employment centers, social and community services, etc., to include a
27 study of the adequacy of the public facilities that will service the site. The report
28 must include a map showing the site and important neighborhood facilities and
29 amenities.

30 b. Any other locational considerations relevant to the market and marketability of
31 the proposed project.
32

1 c. A conclusion concerning the appropriateness/adequacy of the proposed project for
2 the proposed use.

3
4 7. Description of income or rent restrictions imposed on the project by the
5 use of public financing and/or subsidies (e.g., LIHTC, tax-exempt bonds
6 or subordinate loans).

7
8 The report must address, in sections E. and G., how these incomes and rent
9 restrictions will affect potential demand, absorption and long term stabilized
10 occupancy of the income-restricted units.

11
12 8. Characteristics of the proposal that will have a specific bearing on its
13 market prospects and overall marketability, such as location, amenities,
14 features or design.

15
16 D. Housing Market Area (HMA) is the geographic area in which units with similar
17 characteristics, e.g., number of bedrooms and rents, are in equal competition. The
18 location of the competing projects and where the majority of the residents will come
19 from must be discussed. The size of the HMA for general occupancy rental housing
20 can vary significantly depending on the extent and location of comparable and
21 competitive products within a specific area and geography. In some cases, both a
22 primary and secondary market area must be defined. When defining the boundary of
23 a market area, the analyst should consider the locations of comparable and
24 competitive rental developments (existing, under construction and developments in
25 planning) and commuting times from employment. Data on place of work or
26 residence, population from the 2000 to 2010 Decennial Census, American
27 Community Survey (ACS) and local sources will aid in this determination.

28 E. The market study must include the following:

29
30 9. A legible map of the HMA, showing delineated boundaries, location of the
31 subject, major highways and thoroughfares, geographic features like rivers
32 and lakes, and political divisions such as state lines and city limits. The
33 map must have a title, bar scale, north arrow and legend.

34

1 10. A description of the geographic boundaries of the HMA and a justification
2 for the delineation, including a discussion of the location of competitive
3 housing, relevant services and amenities and concentrations of
4 employment opportunities.

5
6 11. A description of the sub-market for the type of housing proposed, defining
7 the economic and demographic characteristics of the target market in
8 terms of income levels, household size and age range of prospective
9 residents. Discuss any tenancy, age, income or special needs restrictions.

10
11 12. A statement of the length of the specified forecast period, which is
12 typically 36-48 months from the current date of the study.

13
14
15 13. For LIHTC Projects. Provide an estimate of demand, including a capture
16 rate, based on potential income eligible residents. An income eligible
17 resident is a resident whose income does not exceed the maximum
18 permitted by the affordability restrictions but who has sufficient minimum
19 income to pay the LIHTC rent without being overburdened. Note: a
20 household or family is considered “rent-burdened” if they pay more than
21 30 percent of their household income in gross rent (“severely rent-
22 burdened” if they pay more than 50 percent). The market study must
23 describe what basis was used for rent burdened: e.g., 30 percent, or some
24 other percent, but in all cases less than 50 percent. To make these
25 determinations, consider the following information and guidance:

26 a. The market study should specify the applicable LIHTC maximum rents,
27 markets rents, and impact on achievable rents and project-based subsidy rents.

28
29 b. When the proposed rents are set at the LIHTC maximums, the market of
30 income qualified residents for the restricted units is comprised of a relatively
31 narrow band of income eligible renters whose incomes do not exceed the
32 maximum but are sufficiently high to pay the rent without being
33 overburdened, which can result in a problem with the market feasibility of the

1 project. Depending on the rental market and income conditions in the HMA,
2 there may be an insufficient number of potential renters that meet the income
3 limit and who are also able to pay the restricted rent. In many markets,
4 LIHTC projects need to set their rents below the maximum permitted. Some
5 LIHTC projects have other forms of assistance (such as Section 8 rental
6 assistance or soft subordinate financing) to further reduce rents and thus
7 expand the number of potential income eligible residents. The market study
8 must identify the estimated number of households who are eligible but not
9 overburdened (would not pay in excess of 30 percent of income for gross rent
10 (includes utilities).

11
12 c. The determination of demand and the capture rate should take into
13 consideration:

14
15 (1) the current and anticipated supply/demand conditions in the overall
16 rental market,

17
18 (2) the potential depth of the market of income eligible households in
19 comparison to the number of units at the proposed rents, and

20
21 (3) the marketability of the proposed units taking into account the project's
22 amenities, rents and location relative to comparable and competitive
23 projects and other available housing options.

24
25 d. Capture Rate is defined as the percentage of households in the HMA that meet
26 any applicable age and household size restrictions and are within any limited
27 income eligible band and who have sufficient minimum income to pay the tax
28 credit rent without being rent overburdened, who the project must capture to
29 fill the units and achieve stabilized occupancy. The Capture Rate is calculated
30 by dividing the total number of units at the project by the total number of
31 households in the HMA that meet the applicable age, size and any income
32 band requirements. The absorption rate is defined as a projection of the pace
33 of unit lease up as units become available for occupancy.

1
2 The Hub/PC should consult with EMAD in assessing the determination of eligible
3 income band, capture rate and absorption rate contained in the market study. If
4 the Hub/PC finds that there is insufficient demand for the units at the proposed
5 rents, the loan should be either rejected or revised by the lender with rents
6 lowered as necessary to broaden the band sufficiently to ensure adequate
7 absorption and achieve stabilized occupancy. If agreement cannot be reached
8 with the borrower on the appropriate rent levels, the project should be deemed to
9 be not feasible and rejected.

10
11 F. General characteristics of the HMA. The market study must include a thorough
12 description of the current and forecast economic and demographic characteristics and
13 conditions of the HMA. The description is necessary to provide background and
14 justification for the subsequent estimates of demand for additional rental housing. The
15 study must include the following:

16
17 14. A discussion of current economic conditions and employment
18 characteristics, including:

19
20 e. Identification of growth sectors in the economy and emerging trends,
21 including a detailed discussion of the sectors in the economy that have a major
22 impact on the local housing market, such as military facilities, colleges and
23 universities, federal and state government, major employers or tourism.

24
25 f. A study of recent trends in employment, including unemployment statistics,
26 demographic data, new job creation or loss, with a detailed discussion of:

27 (1) Historical nonfarm and resident employment levels and changes;

28
29 (2) Any anticipated changes in employment as a result of expected
30 closings, openings, expansions or cutbacks by leading employers, with
31 a particular emphasis on how this would affect the rental market
32 during the forecast period, including any seasonal employment
33 markets.

34

1 (3) Information on the types of new jobs being created and lost, including
2 data on pay scales and how these wage levels relate to the affordability
3 of the proposed rental units.

4
5 (4) List of major employers in the HMA, the type of businesses and the
6 number employed.

7 (5) In relevant markets (such as resort areas), comment on the availability
8 of affordable housing for employees of businesses and industries that
9 draw from the HMA.

10
11 g. A forecast of employment for the specified forecast period and how this
12 forecast supports demand for additional new rental housing.

13 A thorough discussion of past and anticipated future trends in the demographic character
14 of the housing market, covering such subjects as population change, migration, net
15 natural change, household growth or decline, changes in the average household size and
16 changes in tenure. The report must include estimates of the total population and
17 households (by tenure - owners and renters), including estimates as of the current date of
18 the study and the forecast date (3 or 4 years from the date of the study) and a detailed
19 explanation of all significant trends and changes.
20

21 A thorough discussion of past building trends and anticipated pipeline supply for rental
22 housing, including multifamily rental projects both market-rate and income-restricted.
23

24
25 15. Income Restricted Projects. Provide a discussion of other income-
26 restricted projects that are existing under development or proposed in the
27 HMA. Particular attention must be given to potentially competing
28 existing, under construction and proposed projects that would require an
29 eligible income band that is similar to the subject's.

30
31 G. Current housing market conditions. The market study must include a comprehensive
32 description of the current conditions of the rental market and of the sales market, if
33 relevant, in the HMA. This description should include a summary statement on the

1 current condition of the overall rental market and of the rent levels in the market of
2 comparable projects, including the following:

3
4 16. An estimate of the current competitive rental inventory, of both single-
5 family and multifamily units, in the HMA, with data on the number of
6 units by structure type, by number of bedrooms, by rent levels, age and
7 location.

8
9 17. A thorough discussion of recent market trends analyzing the following:

10
11 h. Current occupancy levels and recent trends in occupancy/vacancy in existing
12 rental projects.

13
14 i. Absorption experience of recently completed rental developments, including
15 estimates at a project level of per unit per month absorption rates, with
16 particular emphasis on comparable and competitive projects that have entered
17 the market within the past 24 months. When available, annual absorption of
18 new projects from the past 10 years should be provided.

19
20 j. Current gross rents for comparable and competitive projects, and the trend in
21 rent increases in this inventory during the past 24 to 36 months. The
22 description should identify any services included in base rents or offered at a
23 premium. Where relevant, the report should include information on the extent
24 of rent concessions or similar incentives, particularly in projects in initial
25 occupancy and must address the impact of concessions on rent levels and
26 whether the quoted rents are overstated due to concessions or other factors.

27 k. Estimated current overall rental vacancy rate and vacancy rate for units
28 similar to those in the proposed project. Significant seasonal variations in
29 vacancy rates, if applicable, should be discussed.

30
31 l. Discussion of any vacancy or absorption problems in the market, particularly
32 in the segments of the market most relevant to the subject project, including

1 the cause if the subject's rates are significantly higher or lower than the
2 overall rental vacancy rate.

- 3
- 4 m. The impact, if any, of the single family and condominium market conditions,
5 including an analysis of the cost to rent versus to own, and the impact of
6 foreclosures and of the shadow inventory of single family and condominium
7 units.

8

9 18. The report must include a map showing locations of existing competing
10 rental projects, projects currently under construction, and those in the
11 planning and development process.

12

13 H. Characteristics of Rental Units in the Pipeline, Under Construction and in Planning.
14 The market study must include separate estimates of the numbers of rental units
15 currently under construction and the numbers in the planning and development
16 process likely to enter the housing market during the specified forecast period. These
17 estimates should include all rental developments known, not solely those determined
18 by the analyst to be comparable and competitive. The description of the pipeline
19 activity should clearly identify any significant characteristics of specific
20 developments with rent restrictions or rent limits such as LIHTC or age-restricted
21 occupancy. The report should contain estimates of:

- 22
- 23 1. The number of projects currently under construction, the total number of units, the
24 numbers by bedroom size (number of bedrooms) by rent range, structure type
25 amenities (if available), and their locations.
- 26
- 27 2. The number of projects in planning stages that are likely to be developed, including
28 but not limited to those with building permits or firm financial commitments,
29 including details on the number of units by bedroom size, rents, locations, and stage
30 of development.

31

- 1 3. A list of LIHTC projects in or near the market area that are not yet placed in service,
2 giving as much known detail as possible on estimated placed-in-service dates, unit
3 mix and income levels to be served.

- 4
5
6 I. Demand Estimate and Study. The market study must include an estimate of future
7 demand for the specified forecast period, typically 36 to 48 months. The estimate of
8 demand and the study supporting that estimate must meet the following guidelines:

9
10 19. The estimate of demand must be based on a calculation of incremental
11 demand (i.e. demand for additional new units) and must address the
12 following factors:

- 13
14 n. Renter household growth during the forecast period.
15
16 o. Recent trends in tenure broken down by homeownership and rental that may
17 increase/decrease the demand for rental units.
18
19 p. Replacement of existing rental units lost from the inventory due to demolition,
20 conversion, shifting of owner units into the rental market and by other means,
21 and the effect of any current excess vacant supply, based on an estimate of the
22 balanced market vacancy rate. The demand estimate must reflect the number
23 of rental units that, if added to the inventory during the forecast period, would
24 result in balanced market conditions..

25
26
27 The estimate of demand should be broken down into a qualitative estimate of
28 demand by number of units by bedroom size, rent range, and other relevant
29 characteristics, as necessary.

30

1 The demand estimate should identify the "effective demand" pool of households
2 with sufficient incomes and or applicable household size that would be expected
3 to demand such housing during the forecast period, including the income levels
4 and rent- to-income ratio(s) assumed in the study.

5
6 The study must reconcile the number of units in the proposed project with the
7 demand estimate for the HMA, taking into consideration current housing market
8 conditions, available vacancy, and forecast additions to the supply (under
9 construction and in the pipeline). The study should also include an estimate of the
10 absorption period needed for the project to reach sustaining occupancy based on
11 current market data and the *quantitative and qualitative demand* estimates.

12
13 The market study must include an assessment of the impact the proposed would
14 have on existing rental developments. Specifically, the study must address the
15 impact on existing insured properties and show that demand will come from new
16 renter households, the shifting of households into the rental market, or the
17 replacement of lost or sub-standard units. It must be demonstrated quantitatively
18 that the number of units under construction and the proposed supply, including
19 the subject, will not create over-supplied or overall soft market conditions. Even
20 if the subject does not directly compete with existing insured or uninsured
21 properties, an oversupply of units could spill over into all segments of the market.
22 Discuss demand and calculate the capture rate. For income-restricted units, this is
23 based on the eligible income band considering the proposed income restricted unit
24 mix and restricted rents. In calculating the capture rate it is important to confirm
25 that the income qualified renter households in the HMA used in the determination
26 have an eligible income band similar to the subject. .

27 **J. Housing for elderly persons.** Age-restricted projects qualifying for FHA mortgage
28 insurance fall into four broad categories as follows:

29
30 20. Health-care facilities insured under section 232 of the National Housing
31 Act which include these distinguishing features:

32 q. Require a license administered by a state health care regulating agency

- 1 r. Provide assistance with activities of daily living (ADLs)
- 2 s. Include meals as part of the amenities/service package, usually included in the
- 3 rent
- 4 t. Offer oversight of the dispensation of medications to the residents

5 Note: This program is now administered by the Office of Insured Health Care and is no
6 longer under the jurisdiction of the Office of Multifamily Housing

7 21. Independent living housing for frail elderly

- 8 u. Primarily provide housing
- 9 v. Usually offer optional meals to residents using staff resources or an outside
- 10 contractor.
- 11 w. May offer assistance with ADL on a fee for service basis.

12 22. Age 62 or Older Head of Household

- 13 x. Primarily for residents aged 62 or older but may not discriminate on the basis
- 14 of age for additional family members
- 15 y. Market-rate occupancy

16 23. Fair Housing Exempted Housing Age 55 or Older

17 For affordable properties, FHA will exercise greater flexibility. FHA will grandfather
18 affordable properties with current age restrictions and allow age restriction regimes that
19 may not conform to the otherwise applicable FHA policy, whether the age restrictions are
20 imposed by HUD; the Low Income Housing Tax Credit Program (Housing Credit); and
21 state, local, zoning, or affordable programs, as long as these properties meet both the
22 relevant elderly use restrictions imposed by the applicable program and comply with the
23 Fair Housing Act.

24 Assisted, age-restricted properties that serve a mix of elderly and non-elderly disabled
25 residents pursuant to a HUD regulatory agreement or other HUD requirement will be
26 permitted to continue to serve their targeted populations, regardless of the type of
27 mortgage insurance, direct loan, or grant financing previously used. Affordable
28 properties are defined as projects with project-based Section 8, Housing Credits, Section
29 202 refinancings, or “older assisted” FHA mortgage insurance programs.

30 24. Program limitations, services and amenities which may impact

- 1 marketability, market share, and projected occupancy rates
- 2 a) The estimated total monthly fees for shelter and any separate fees charged for
- 3 any optional services per resident by type of occupancy or accommodation.
- 4 b) The estimated total monthly fees for any optional services provided on an as
- 5 needed per resident basis.
- 6 c) The proportions of the project to be occupied by market rate residents and by
- 7 public pay/assisted residents-tenants, e.g. Optional State Supplement.
- 8 d) The amenities and special services to be provided and how they support the
- 9 physical, mental, or social conditions of the prospective residents.
- 10 e) The project location and its proximity to facilities and services essential to
- 11 elderly residents such as hospitals, medical/health care facilities, social and
- 12 community services, public transportation, shopping and recreational activities;
- 13 and any other locational considerations relevant to the market or marketability of
- 14 the proposed project. Include a map showing the site and important facilities and
- 15 services.
- 16 6) The market study should include a discussion about any unique features of the HMA where
- 17 the project is located, including:
- 18 a) the locations of the prior residences of the current occupants in comparable and
- 19 competitive existing projects, for purposes of identifying the geographic area
- 20 from which the proposal may be expected to draw prospective residents; in
- 21 addition, if some portion of prospective residents are expected to come from
- 22 outside of the market area, this must be fully explained,
- 23
- 24 b) any concentrations of elderly population, (If applicable, they should be identified
- 25 as a potential long term source of demand for senior housing.)
- 26
- 27 c) a description of the sub-market for the type of housing and care proposed by the
- 28 economic and demographic characteristics of the target market (projected
- 29 residents): income levels, wealth and assets, household size, age of prospective
- 30 residents, physical and/or mental limitations, homeownership rates, and other
- 31 similar factors,
- 32
- 33 d) a description of home sales market conditions, if relevant; including the impact,
- 34 if any, of mortgage foreclosures, declining home prices, or other factors which
- 35 could limit the ability of elderly homeowners to sell their homes and extract
- 36 equity for the purpose of defraying the costs of shelter and care in an age-

1 restricted facility,
2

3 e) description of the current inventory foreclosures and defaults, quantitative and
4 qualitative characteristics of projects in the market area, occupancy rates and
5 waiting lists,
6

7 f) total monthly charges by unit type, including the monetary level of concessions,
8 type of accommodation, and level of services,
9

10 g) typical types of services and amenities offered, whether mandatory or optional
11 fee for services, and whether services are provided by the facility (directly or by
12 contract) or through a third-party arrangement (tenant-resident and provider and
13 any added costs for optional services),

14 Note: Mandatory meal services are not permitted in FHA-insured multifamily
15 properties. Projects offering these services may be considered in other HUD
16 programs (e.g. 232 or existing 202 projects).

17 absorption experience of recently completed projects on a units per month basis,
18 discussing the level and extent of pre-sale or pre-marketing efforts.
19

20 7) Characteristics of Age-restricted Units in the Pipeline, Under Construction and in
21 Planning. The market study must include separate estimates of the numbers of age-
22 restricted units currently under construction and the numbers in the planning and
23 development process likely to enter the housing market unique to elderly persons during
24 the specified forecast period. These estimates should include all developments known to
25 serve the target population, not solely those determined by the analyst to be comparable
26 and competitive. The description of the pipeline activity should clearly identify any
27 significant characteristics of specific developments with rent restrictions or age-
28 restricted occupancy. The report should contain estimates of:

29 a) Total monthly charges by unit type, type of accommodation, and level of services,
30 with information on the added costs for optional services.

31
32 b) Typical types of services and amenities offered, whether these are mandatory or
33 optional fee for services, and whether services are provided by the facility (directly or
34 by contract) or through a third-party arrangement (resident and care provider).

1 8) Demand Estimate and Study. The market study must include an estimate of future
2 demand for the specified forecast period, typically 36 to 48 months. The estimate of
3 demand and the study supporting that estimate must meet the following parameters

4
5 a. The demand estimate should reflect "effective demand" and should be based on
6 the numbers of elderly households meeting the relevant economic and
7 demographic criteria (sufficient incomes, age, household size, and need for the
8 type of shelter and care) that reasonably could be expected to demand such
9 housing during the forecast period.

10
11 b. The report must include a descriptive study of the demand estimate that addresses
12 the primary determinants including:

13
14 (i) Current and forecast population and households of the target group(s) by
15 the appropriate age cohort and the proportion of the market each group
16 comprises.

17
18 (ii) Current income level/band of income of prospective households
19 comprising demand, including cost/rent to income ratio(s) assumed in the
20 study.

21
22 (iii) Changes in the population (including migration patterns) of adult children
23 of the potential elderly occupants. Discuss the impact of anticipated
24 population changes on the demand for the project and the portion of
25 demand expected to come from outside of the primary market area.

26 K. Additional Requirements for Projects Designed for Elderly Persons, Basic
27 Assumptions of the Study. The technical and analytical methods used by the market
28 analyst and all conclusions must be consistent with the following assumptions:

29
30 25. There is a direct relationship between the housing and needs or
31 requirements of an elderly person and the limitations in activities of daily
32 living imposed by the physiological, psychological, and social changes of

1 the elderly. Therefore demand and need vary between different age-
2 cohorts of elderly for particular types of housing.

3
4 26. The demand within each age-cohort for a particular type of product will
5 depend on the housing and services offered and how well these meet the
6 physical, mental and social conditions and service or care needs of persons
7 within each age-cohort.

8
9 27. In addition to their normal source of income (pensions, social security, and
10 retirement funds) the elderly demanding shelter and care will use some
11 portion of their assets (net worth) to defray the cost of shelter and care.
12 Elderly homeowners may sell their homes and use part of the investment
13 income from the net equity toward the monthly housing expenses.

14
15 28. The proportion of income an elderly household is willing to pay for a
16 particular housing product (cost-to-income ratio) will depend on the type
17 and extent of services included in the total monthly cost. The more
18 extensive the level of shelter and services the higher the ratio. The cost to
19 income ratio is defined as the sum of the shelter rent, utilities, and typical
20 service charges, divided by the total monthly household income. Cost to
21 income ratios are a function of the type of housing product and the level of
22 services and amenities provided. The cost to income ratio used in the
23 study should also reflect what is reasonable and customary for the
24 particular type of housing in the subject market area, taking into
25 consideration recent market experience of comparable and competitive
26 product. A guideline for cost-to-income ratios for age-restricted rental
27 apartments with no services should be in the 40-50 percent range to
28 establish a minimum income..

29
30 29. For most market segments, one-person households comprise the major
31 segment of the demand for housing and supportive services for the elderly.
32 Therefore, any estimates of demand based on data for the total elderly
33 population or for all elderly households, must be adjusted to be consistent

1 with actual market experience and occupancy by household size in
2 existing competitive product.

3
4 30. Household Sizes and Counts. Use of data on all household sizes must be
5 adjusted to derive an accurate demand estimate, consistent with the
6 characteristics of the target market. If an analyst makes an estimate of
7 demand using data for all households, without making an adjustment for
8 household size, the subsequent estimate of potential demand will be
9 significantly overstated.

10
11 31. Using counts for total households substantially overstates the number of
12 income affordable households. Census data indicates that incomes of two-
13 person households are approximately twice that of respective one-person
14 households. Consequently any distribution of elderly households will
15 have a greater proportion of two-person households in the upper income
16 ranges than one-person households. Analyses shows that at most every
17 income level, two-person households typically out-number one-person
18 households by a factor of two or three to one, as the age of the household
19 increases.

20
21 32. Unless a factor is applied to the "all household" count to adjust for this
22 bias, the demand estimate is incorrect. The suggested methodology to
23 determine the number of elderly households is to measure the number of
24 income eligible elderly one-person households and then adjust this count
25 to take into account households of other sizes.

26
27 L. Additional Requirements/Guidance for Income Restricted Projects. According to
28 USPAP Advisory Opinion 14:

29
30 “Subsidized housing may be defined as single- or multifamily residential real estate
31 targeted for ownership or occupancy by low- or moderate-income households as a result
32 of public programs and other financial tools that assist or subsidize the developer,
33 purchaser, or resident in exchange for restrictions on use and occupancy.” While HUD

1 provides the primary definition of income and asset eligibility standards for low- and
2 moderate-income households, other federal, state and local agencies define income
3 eligibility standards for specific programs and developments under their jurisdictions.
4

5 The competency required of appraisers and market analysts to appraise or prepare market
6 studies for subsidized housing extends beyond typical multifamily residential experience
7 and requires an understanding of the various programs and definitions involved in the
8 particular subsidy program applicable to the development. Practitioners should be
9 capable of analyzing the impact of a particular subsidy program in both the general
10 market and the local subsidized housing submarket. Political changes may affect these
11 requirements and therefore must be fully understood.
12

13 M. Data, Estimates, and Forecast. The study should document the methods and
14 techniques used to develop all estimates and forecasts and provide adequate citations
15 on the sources of all data, estimates and forecasts which citations must be relevant
16 and current. Conclusions in the study must be consistent with the facts presented;
17 findings and recommendations should be based on a reasonable forecast of market
18 supply/demand conditions and sound assumptions regarding capture rates, absorption,
19 achievable rents, income affordability and similar factors. To the extent possible, the
20 qualitative and quantitative estimates of demand for additional rental units should
21 take into account the changes in renter households by household size, not just in total.
22 Although data for all household sizes may be used, a study of the trend of change by
23 household size may derive a more representative and accurate demand estimate
24 consistent with the characteristics of the target market.
25

7.6 Appraisal Requirements

A. The development of the appraisal must comply with USPAP Standards Rule 1, and the Scope of Work Rule and assignment conditions outlined throughout this guidebook. The report shall be in a narrative format, comply with USPAP Standards Rule 2, and contain all of the information necessary for loan underwriting and for the reviewer to easily understand the reasoning employed by the appraiser. Standard 2 does not dictate the form, format, or style of real property appraisal reports. The form, format, and style of a report are functions of the needs of the client and intended users. The substantive content of a report determines its compliance.

B. Effective Date. For pre-applications, all appraisals must have an effective date within 120 calendar days before the date of the pre-application package. For Firm Commitments, the effective date of the appraisal must be within 180 calendar days prior to the issuance of the Firm Commitment. The MF Hub/PC may require an updated appraisal prior to an amendment, re-issuance or an extension of the Firm Commitment, e.g., if there is a material change in the terms of the mortgage or in the market conditions and market data upon which the Firm Commitment was based. Expired reports may be amended or updated as needed by re-surveying all relevant data. HUD defines the effective date as the most current date that the appraiser inspected the subject, comparables and has made estimates of rents and expenses. Updated appraisals can be submitted if the appraiser re-inspects the exterior of the subject project, re-surveys the rental comparables, and reviews the market for any additional sales comparables. Follow USPAP Advisory Opinion 3 for guidance on completing and reporting appraisal updates. Lenders should provide for updates in their response to the invitation letter in case of processing delays prior to issuance of the Firm Commitments.

C. Brevity. The appraisal should be clear and concise. The appraisers should reference in the body of the report conclusions derived by the analysis of large tables of data should be referenced in the body of the report and necessary supporting data should be included as an addendum. Avoid verbatim quotations of large portions of published national and regional reports. Appraisals must be submitted as a searchable PDF file with one signed hard copy.

1 D. Complex or Unusual Appraisal Assignments. When an appraisal assignment involves
2 a subject with property rights issues or other unusual circumstances, third party
3 appraisers must be sure to comply with USPAP Standards Rule 1-1(a), “In developing
4 a real property appraisal, an appraiser must be aware of, understand, and correctly
5 employ those recognized methods and techniques that are necessary to produce a
6 credible appraisal.”

7 When an appraisal or valuation assignment involves complex or unusual valuation
8 issues, the lender should consult with the Hub/Satellite Office at a concept meeting
9 before appraisal assignment begins.

10 **E.** Form HUD-92264 and supporting forms HUD-92273, HUD-92274, and HUD-92264T
11 (if applicable) must also be prepared and included in the report.

12
13 F. The USPAP Jurisdictional Exception rule is not generally applicable in HUD appraisal
14 assignments. Limitations on occupancy rates and commercial income/space, etc.,
15 imposed by the insurance programs are considered to be conditions of the assignment.
16 Nevertheless, the USPAP Jurisdictional Exception Rule clearly states that if in an
17 applicable law, which includes administrative rules such as the MAP Guide and HUD
18 Notices precludes compliance with any part of USPAP, that part of USPAP becomes
19 void for that assignment.

20
21 G. Occupancy Percentage. Unless otherwise noted, the occupancy used in the valuation
22 of properties for acquisition or refinance should be based on the occupancy that is
23 prevalent for the subject’s area. This is reflected in Criterion 3 on the form HUD
24 92264-A. The estimate of occupancy should take into account the historical
25 performance of the subject and the vacancy and collection loss typical for the subject’s
26 market area to determine the occupancy percentage. The appraiser should ignore
27 unsustainable market conditions and short-term spikes in the occupancy rate due to
28 seasonal changes and short-term demand for specialized employment, i.e. disaster
29 relief workers.

30
31 H. Underwritten Occupancy. FHA programmatic constraints imposed on the maximum
32 underwritten occupancy are applied in calculating the mortgage constrained by debt
33 service coverage (Criterion 5). Underwritten vacancy rates will be at the greater of the
34 minimums below or actual levels. The MAP Lender’s third party Appraiser should use

1 actual vacancy rates, which are generally expected to be no lower than the rates listed
2 for underwriting and sizing debt service mortgages discussed in Section 7.7.

- 3 I. Sections 220, 221(d), and 231 (new construction only) do not call for an “as complete”
4 value conclusion. The Department considers valuation work for these assignments to
5 be an appraisal that is developed and reported in compliance with USPAP Standards 1
6 and 2.

- 7
8 1. By statute, these are replacement cost limited mortgages and require a site
9 valuation, a debt service analysis and a cost approach to value. An estimate of
10 the market value after completion is not required or relevant. The appraiser must
11 fully examine the proposed construction costs of the subject project. Plans,
12 specifications and development costs must be presented, analyzed and supported
13 by the cost approach using either a subscription cost service such as Marshall &
14 Swift, the lender’s cost analyst or a direct comparative analysis of recently
15 completed similar developments. Substantial Rehabilitation projects require an
16 estimate of the “As Is” value of the project by use of the income and direct sales
17 comparison approaches to value when possible. Unoccupied or “shell” structures
18 may be appraised using the sales comparison approach and/or cost approach.

19 **NOTE: See special instructions for Cost Certification as it relates to As Is**
20 **Valuation in Chapter 13.21**

- 21
22 2. Exhibits. The appraiser and the MAP Underwriter must assure that there is
23 sufficient narration and exhibits to allow a reliable underwriting decision to be
24 reached. This should include, but is not limited to, location maps, photographs of
25 the subject, rent and expense comparables, site and floor plans, along with
26 thorough explanations of all adjustments.

- 27
28 J. For Section 223(f), apply all three approaches to value for subjects that have an actual
29 age of less than ten years. The appraisal should assume that any proposed
30 repairs/improvements have been completed, as rents, expenses and value must reflect
31 completion of any proposed repairs or improvements.

32

1 1. Cost/ Summation Approach. The cost or summation approach must consider
2 all applicable forms of depreciation, functional and external obsolescence.
3 The cost/summation approach shall not automatically set the upper limit of
4 value for these programs. However, this policy is not intended to negate the
5 necessity of the final reconciliation of the three approaches to value but is
6 rather an acknowledgment of the basic principle of substitution in that no
7 prudent purchaser would pay more for a project than the cost to acquire a
8 similar site and construct improvements of equal desirability and utility. This
9 approach may be eliminated at the discretion of the appraiser for subjects that
10 are ten or more years old.

11
12 2. Sales Comparison Approach. In multifamily housing, the entire project
13 typically does not offer a convenient basis for comparison with other entire
14 projects due to differences in size, composition, areas, units and rooms.
15 Acceptable units of comparison are price per living unit, price per room, and
16 price per square foot of gross building area (GBA).

17
18 3. Income Approach. The annual net operating income (NOI) remaining after
19 the payment of expenses is considered to be the primary source of value to the
20 project. The preferred method of capitalizing the NOI into a value estimate is
21 Direct Capitalization. There are several acceptable techniques for deriving
22 capitalization rates. Rate Extraction based on recent (preferably within the
23 past year) comparable sales is the most preferred. Band of Investment,
24 Ellwood, and Sinking Fund, etc. are also acceptable. The appraisal should
25 also contain discussion of how the chosen capitalization rate compares to rates
26 listed in published reports such as Price Waterhouse Cooper realtyrates.com,
27 etc. Discounted Cash Flow Analysis may be used only in certain situations
28 involving leaseholds. See Chapter 7.15.

29 The Capitalization Rate must be based on factors reflecting the overall
30 demands of knowledgeable investors in properties similar to the subject.
31 Regardless of the method used in deriving the rate; it must be supported by
32 current market information, i.e. recent sales, typical loan terms and return on
33 owner's equity. The appraiser must report all market comparables used to
34 derive the Capitalization Rate.

- 1 K. For Section 231 Substantial Rehabilitation cases, follow the instructions for Section
2 223(f). Substantial rehabilitation under Section 231 differs from Sections 220,
3 221(d)(3) and 221(d)(4) in that a market value based on the completion of the
4 rehabilitation is required.
- 5 L. Remaining Economic Life (REL). HUD Multifamily Housing programs allow long
6 term amortization periods. Accordingly the Underwriter must determine the REL and
7 the remaining useful/physical life based on review and reconciliation of the appraisal,
8 PCNA and their own observation. This estimate is not a formulaic calculation. REL is
9 defined as the estimated period during which improvements will continue to contribute
10 to project value and an estimate of the number of years remaining in the economic life
11 of the structure or structural components as of the date of the appraisal. For new
12 construction and substantial rehabilitation projects, the maximum mortgage term is the
13 lesser of 40 years, or 75 percent of the REL. For existing properties, the maximum
14 mortgage term is the lesser of 35 years, or 75 percent of the REL.

15
16 When used in this section, the words and terms below are defined as follows:

- 17 1. Physical Life - is the period from the time of completion (as new or after
18 substantial rehabilitation) of a structure until it is no longer fit or safe for use
19 or when maintaining the building in a safe, usable manner is no longer
20 practicable. Because a building is subject to physical deterioration and
21 obsolescence, its period of usefulness is limited. As a building deteriorates
22 or becomes obsolete, its ability to serve useful purposes decreases and
23 eventually ends. This may occur gradually or rapidly.
- 24 2. Economic Life - The period over which improvements to real property
25 contribute to property value. Economic life can never be longer than the
26 physical life, but may be shorter. Both Physical and Economic life will be
27 affected by the underlying construction quality, market incentives, level of
28 maintenance/updating to correct physical deterioration and/or functional
29 obsolescence.
- 30 3. Functional Obsolescence - is a reduction in the usefulness or desirability of
31 the improvements to real property due to the presence of outmoded features
32 such as lack of closet space or the number of bathrooms commensurate with

1 the number of bedrooms. Such features are often not curable and may or
2 may not be relevant in evaluating the REL.

3 4. Effective Age - is the apparent age of the improvements to the real property
4 and may vary from its actual or chronological age. The effective age is
5 determined by the appraiser assuming the required repairs to be made as
6 specified in the PCNA as a condition of refinancing and based on the
7 following factors:

8 a. Workmanship, durability of construction and the rate with which
9 natural forces cause physical deterioration;

10 b. The physical condition and probable cost of maintenance and
11 repair, the maintenance policy of owners and occupants and the
12 use or abuse to which structures are subjected;

13 c. The economic background of the community or region and the
14 need for accommodations of the type represented;

15 d. The relationship between the property and the immediate
16 environment, the architectural design, style and utility from a
17 functional point of view and the likelihood of obsolescence at
18 attributable to new inventions, new materials and changes in tastes;

19 e. the trends and rate of change of characteristics of the neighborhood
20 and their effect on land values.

21
22
23
24
25 5. Estimation of the REL. REL is the Economic Life less the Effective Age.
26 The effective age is determined by the appraiser based on the actual
27 condition of the subject considering all applicable forms of depreciation.
28 The appraiser should assume the required repairs to be made as specified in
29 the PCNA as a condition of refinancing and consider the type and quality of
30 construction, maintenance factors, and any other relevant market and
31 economic factors that might influence the long term success of the project.

1 Examples that illustrate the implementation of these concepts are set forth below:

2 ***An older structure with functional obsolescence remains competitive in an area that is***
3 ***dominated by modern apartment projects commanding higher rents.***

4 Such structure could be a market rate project in a particularly desirable location, or a
5 former public housing project. The MAP appraiser's market analysis indicates that
6 there is a lower income population in the market area that will likely allow the project
7 to remain competitive for a long term. This can cause the effective age to be lower,
8 with a commensurate increase in REL.

9 ***A structure that is sound and in good physical condition with many years of physical***
10 ***life remaining may have reached the end of its economic life - if its remaining years***
11 ***of physical usefulness will not be profitable.***

12 Apartment projects in a given market area have either been severely damaged or
13 destroyed by a hurricane. Most of these properties are either being replaced by new
14 structures or are receiving substantial renovation that will include correction of
15 functional obsolescence. This could result in a lower effective age with a
16 corresponding increase in REL.

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22 M. HUD is the regulatory enforcement agency identified in the Confidentiality Rule of
23 USPAP. Appraisers will be required to present their entire work file and fully disclose
24 the identity and source of confidential information should the Department determine a
25 review of the appraiser's work file is in order. (Note that, per USPAP, disclosure to
26 enforcement agencies does not constitute a violation of the Confidentiality Rule.) The
27 appraisal must be prepared with the list of information contained in Appendix 4.

28
29 N. Include an appraiser's Certification with the format in Chapter 11 as well as the most
30 current USPAP certification

31
32 O. Inspection of the Subject and Comparables. The primary appraiser designated by the
33 lender and accepted by HUD must physically inspect the subject (both exterior and
34 interior) and all of the comparables used as part of the analysis. The primary appraiser

1 must also sign the Certification within the appraisal report and the supporting HUD
2 forms.

3
4 a. The primary appraiser must inspect at least one of each bedroom/unit type. The
5 total number of units inspected must equal or exceed 5% of the total number of
6 units for projects of up to 200-units, or 4% of the total number of units for
7 projects greater than 200-units. If the characteristics and/or condition of the
8 subject indicate that a higher level of inspection is necessary, it is the appraiser's
9 responsibility to expand the scope of the work as is necessitated by the
10 observations made by the primary appraiser during the inspection of the subject.
11 This is especially important where the improvements are high-rise structures
12 whereby individual units within demonstrate varying degrees of light and view
13 qualities. If there are hazardous conditions or other factors that preclude a
14 thorough inspection of the interior, the appraiser must clearly indicate these
15 circumstances in the appraisal report.

16
17 b. For large projects exceeding 500 units, the lender may permit a lesser percentage
18 but reasonable number of units to be inspected by the appraiser. In addition, the
19 appraiser may employ assistants to inspect individual units so as to encourage a
20 thorough inspection. The names and qualifications of these assistants must be
21 disclosed in the appraisal report. The assistants are not required to sign the report.

22
23 c. The primary appraiser must inspect all of the comparables used in deriving and
24 estimate of value, including land comparables (if applicable), improved
25 comparables sales, expense comparables and rental comparables. The appraiser
26 must verify the condition of the comparables with management or other personnel
27 familiar with the project whose contact information must be documented in the
28 appraisal report.

29
30 P. Required Appraisal Report Exhibits. Photographs (subject, and all comparables
31 including rentals), regional map, location map, satellite scans (if available from
32 Google, Bing, etc.), flood hazard map, survey (if available), floor plans (for each type
33 of unit being offered - if available), site plan, zoning map, tax map, land sales

1 comparable map, rental comparable map, and improved sales comparable map are
2 required with all submissions.

3
4 Q. Market Analysis Requirements for Multifamily Appraisals. The appraisal must also
5 contain, depending on the complexity of the project and prevailing market conditions,
6 a Level B or C Market Analysis of the local market with an emphasis on multifamily
7 housing so as to determine the ability of an existing project to continue usage as
8 multifamily housing. In the case of proposed construction or substantial rehabilitation,
9 the purpose is to determine overall feasibility and demand for new housing units. A
10 brief outline of a Level C analysis follows:

11
12 a. Location. This includes a general description, specific analyses of site linkages and
13 urban growth determinants and detailed competitive location rating.

14
15 b. Demand Analysis. This includes a discussion of general evidence of sales/leasing
16 activity, general city/area growth trends, market absorption, demand and need
17 forecast based on population, employment and income and a demand forecast of the
18 subject market segment.

19
20 c. Competitive Supply Analysis. This includes vacancy rates for comparables and
21 from market surveys (secondary data), field research on all competitive and proposed
22 properties, building permit analysis, identification of proposed sites, and a detailed
23 competitive amenities rating.

24
25 The detailed requirements for performing a Level B or C analysis can be found in
26 “Market Analysis for Real Estate”, published by the Appraisal Institute. In general, a
27 stable market evidenced by a recent sales, and balanced supply and demand is an
28 indication that a lower level “B” analysis will be sufficient. If there is uncertainty in
29 determining the level of analysis, the lender and appraiser should jointly consult with
30 the Hub or Program Center.

31

7.7 Estimating Project Income

A. Rental estimates. The appraiser must estimate the annual gross income of the subject project including estimates of income from market comparables, rental concessions, and an assessment of the general health of the rental market. The gross income estimate assumes a full occupancy level and reflects rent levels current as of the appraisal date or date of the market study. Also, consider the effect that any proposed repairs to the project will have on rents, expenses, and net income; however not all repairs will increase rents, occupancy, net income, and/or decrease expenses.

Rent comparables. Market rent by comparison shall be estimated by the appraiser and documented on the HUD-92273. Note that use of Form HUD-92273-S8 is not authorized for application processing except in cases where the appraisal is also being used as Rent Comparability Study (RCS). A separate HUD-92273 is to be prepared for each type and size (if significantly different) of rental unit in the subject project.

Market rents attributed to the subject property should not be speculative. If rents are based on levels achievable assuming that proposed repairs are completed, then those units that have had repairs completed and are leased are most reflective of market or near market rent levels. The rent comparables and units selected for comparison must be as similar as possible to the subject project and units as to location, structural type, number of bedrooms, and average unit size. In order to ensure they are truly comparable and competitive with the subject project, appraisers should generally not use rent comparables located outside of the subject's market area, but should be from areas similar to the subject and should be fully explained in the report. Market rate units from partially assisted projects can be used as rental comparables in the absence of better rental data.

B. Adjustments. Consistent adjustments for significant differences between the comparables and the subject units shall be derived from the market and applied to the subject rent estimate. Rental adjustments are always made to the comparables reflecting differences with the subject project.

C. The appraiser should select the final rent estimate based on accepted correlation procedures:

Generally, the indicated rent estimate will be from the central 60% of the rental range of

1 the indicated rents after proper adjustment. In situations where the appraiser gives the
2 greatest weight to the highest or lowest comparables, the appraiser must explain and
3 substantiate with market data why the chosen comparables are the most reliable. Often
4 the best comparables are those that require the least amount of adjustment. Just as the
5 most appropriate rent comparable must receive more weight, the general health of the
6 rental market must be recognized before relying upon one or two optimistic indicators.

7
8 On LIHTC and/or bond financed projects, the Form HUD-92264T must be completed to
9 determine the appropriate processing rents.

10
11 D. Trending of Rents. Rental estimates shall be made as of the appraisal or market study
12 date and may not be trended to a future date. Since rent estimates are made based on
13 street rents currently being obtained by the comparables, no time adjustment is needed for
14 an estimate as of the appraisal or market study date.

15
16 E. Equipment included in Rent. Equipment included in the subject rent such as ranges,
17 refrigerators, microwave ovens, air conditioning equipment and laundry facilities must be
18 identified. Services included in the subject rent frequently include heat, air conditioning,
19 water, and trash removal, and must also be identified. Comparable project equipment and
20 services must correspond to the same items of equipment and services provided in the
21 subject proposal and the adjustment process must reconcile any differences. This analysis
22 also applies to the analysis of expenses.

23
24 F. Occupancy/Vacancy and Collection Losses for Residential Units. The appraiser must
25 establish a factor for vacancy and collection loss when determining the effective gross
26 annual income for the residential units. The factor must consider both historical and
27 current data (applicable for existing properties) of the subject project, the rental
28 comparables and any anticipated changes in the market. The factor selected must reflect
29 long-term occupancy rates that are expected to continue. The estimate of occupancy
30 should be based on the actual occupancy of the subject without regard to programmatic
31 constraints imposed on the maximum underwritten occupancy when calculating debt
32 service coverage. The estimate of occupancy should take into account the vacancy and
33 collection loss typical for the subject's market area and, if applicable, be consistent with
34 the subject's historical performance.

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It is appropriate to recognize higher occupancy rates for various types of affordable properties, including LIHTC projects and properties assisted with project based Section 8 HAP contracts. The MAP Lender’s third party Appraiser should use actual vacancy rates, which are generally expected to be no lower than the vacancy rates set forth below (which are used for purposes of underwriting and sizing the debt service mortgage). The underwritten vacancy rates will be the greater of the minimums below and actual levels. In all cases the appraiser should use income from actual operations and market conditions in determining value.

<i>Minimum Vacancy and Collection Loss Rate</i>	<i>Property Type</i>
3%	<ul style="list-style-type: none"> • HUD-assisted property with HAP contract on 90% or more of the units; <u>or</u> • In-place rehab with greater than 90% occupancy and greater than 90% of the units set aside as LIHTC units, with attainable tax credit rents at least 10% below market (i.e. a “discount to market”).
5%	<ul style="list-style-type: none"> • 80% of the units are set aside as LIHTC units, with attainable tax credit rents at a 10% discount to market.
7%	<ul style="list-style-type: none"> • LIHTC without a 10% discount to market; or • 20% or more of the units are Market Rate.

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G. Commercial Income. Where commercial facilities are included in a mixed-use project, a separate analysis must be made of the effect that the commercial operation will have on the project. The appraiser must calculate income, vacancy and collection loss, operating expenses, and replacement reserves attributable to commercial space separately from the

1 residential space. Project paid resident improvements must be accounted for as a leasing
2 expense, and if applicable, a separate commercial-space operating deficit must be
3 calculated in addition to the required residential operating deficit.

4
5 A separate analysis must be performed for each type of space using the Form HUD-
6 92273 or a similar format to summarize appropriate adjustments to comparable data.
7 These studies can be incorporated as a separate section in the overall residential market
8 study submitted at the pre-application or firm stages, depending on the program
9 requirements, and must also comply with Appendix 7A. Care must be taken in reviewing
10 the allowable square footage and income percentage attributable to the commercial/office
11 space since these requirements vary by program. See table below:

DRAFT

Commercial Space and Income Limitations		
SOA	Allowable Percentage of Total Net Rentable Area	Allowable Percentage of Effective Gross Income
221(d)(3) & (4) and 231	25%	15%
220	25%	30%
223(f)	25%	20%

1
2
3 **H. Limited Waiver of Commercial Income and Space Limits**

- 4
5 1. **Commercial Income Limits.** Regional Center Directors may issue waivers of the
6 commercial income limits in Section III B, above, for any programs so long as the
7 amount does not reflect a property that is primarily commercial rather than
8 residential. The Regional Center Director’s approval must document that the project’s
9 commercial component will contribute to meeting the Department’s Strategic Plan
10 Goals, including promoting sustainable communities or supporting transit-oriented
11 development. If the lender requests a waiver of the commercial income limits, the
12 request must be supplemented by a complete credit analysis of all existing or pre-
13 leased commercial tenants may be required. Waivers may be granted where there are
14 clear mitigating circumstances that justify such a waiver. Examples include but are
15 not limited to:
- 16
17 a. A long-term lease with a credit-worthy tenant, such as a government agency or a
18 large, well-established corporation;
- 19
20 b. A multi-tenant commercial space where most of the tenants have a long history of
21 occupancy (5 or more years) and full occupancy of this space is not needed to provide
22 a break-even cash flow for the project; or
- 23
24 c. There is substantial borrower equity and/or local government funds that mitigate risk.
- 25

1 2. Commercial Space Limits. Regional Center Directors may issue waivers to exceed
2 the commercial space limits in Section III B, above,. In order to justify a request to
3 waive the commercial space limitation, the owner must demonstrate:

4
5 a. that the additional space will not negatively impact on the use of the project by its
6 residential tenants and will not create a nuisance to the surrounding community,
7 so as to create a situation where the project is no longer residential in nature

8
9 b. there is ample market support to assure occupancy of the space within the
10 projected absorption period; and

11
12 c. any issues involving easements, liability insurance, parking and zoning must be
13 resolved prior to granting the waiver.

14 I. Unlike the valuation of the residential portion of a mixed use project, the appraiser must
15 value the commercial portion of the project, by applying the programmatic income and space
16 limitations used to establish the commercial NOI for calculating debt service coverage (see
17 Chapter 3).

18
19 1. The appraiser must: Conduct a complete analysis of at least three commercial
20 income and expense comparables and provide a photograph, the resident's name,
21 type and address of business, square feet, rent, vacancy, any concessions and major
22 lease terms for each comparable.

23
24 2. Provide data to support the subject's commercial vacancy rate in relation to the
25 market commercial vacancy rate and review the rollover risk and cost of resident
26 improvements to re-lease space. Use a vacancy factor of not less than 10% for
27 Section 223(f) and 20% for Section 221(d) and Section 220 new construction or
28 substantial rehabilitation to obtain effective gross commercial income for
29 underwriting purposes.

30

- 1 3. Provide the term, commencement date, expiration date, and name of the resident,
2 square footage, and calculation of gross rents, expenses, reimbursement of expenses,
3 cancellation clauses, and renewal clauses for each lease.
- 4
- 5 4. The project expense estimate must include all commercial expenses payable by the
6 project owner. The analysis of all commercial income and expenses must be
7 reflected on Form HUD-92264 with all the supporting data attached to the form. The
8 expense estimate must include all commercial expenses payable by the owner. The
9 analysis of all commercial income and expenses must be reflected on Form HUD-
10 92264 with all the supporting data attached to the form.
- 11
- 12 J. Project Rent Concessions. Rent concessions in comparable projects must be included in the
13 analysis and an appropriate adjustment made to the subject rent based on the comparable units.
14 The adjustments must reflect the actual impact on gross annual income resulting from the
15 comparable rental concession.
- 16 K. Occupancy. When the occupancy rate in a comparable project is significantly less than the long-
17 term occupancy rate estimated for the subject, a downward adjustment should be made to the
18 comparable's rent. If other factors such as condition have had an effect on occupancy, care
19 should be taken to avoid excessive and duplicative adjustments for interdependent factors. The
20 appraiser must note the actual market derived commercial vacancy/occupancy rate in the
21 appraisal report. However, the appraised value of the commercial space component for
22 acquisition/ refinance or the underwritten net operating income (NOI) for new
23 construction/substantial rehabilitation projects must assume either the lesser of what is indicated
24 by market or the occupancy limitations of the specific program.
- 25 For all programs except Section 223(f), the maximum underwritten commercial occupancy rate
26 shall be the lesser of: a) that indicated by the market, or b) 80 percent. For Section 223(f), the
27 maximum underwritten commercial occupancy rate shall be the lesser of: a) that indicated by the
28 market, b) the actual occupancy rate of the subject, or c) 90 percent. For special instructions
29 related to the maximum underwritten occupancy rate for non-tenant parking income see Section
30 7.7.M.2.
- 31 L. Utilities/Services. All of the items for consideration under this heading refer to the cost of the
32 services of water, sewer, gas and electricity that may be included in the rent. In some cases, even

1 though both the subject and the comparable units have the same service included in the rent, an
2 adjustment may still be warranted to bring the comparable in line with the subject, due to size,
3 equipment, utility rate, type of utility, etc. If included in the comparable rent, but not in the
4 subject, enter a negative adjustment reflecting that portion of the comparable's rent attributable to
5 the inclusion of the service. If excluded from the comparable rent, but included in the subject
6 rent, enter a positive adjustment reflecting the estimated increase in rental value attributable to
7 including the service in the subject's rent.

8 M. Project Location, Amenities and Other Factors Consider the subject location relative to distance
9 from shopping, recreational, social, and medical and employment centers, neighborhood
10 desirability, transportation, special hazards and nuisances..

11 1. "Other" items that may be considered include but are not limited to, the following:

- 12 a. Livability—reflect good or poor unit design and configuration, including room
13 sizes, layout adequacy of closets, lighting, elevators and laundry facilities, etc.
- 14 b. Condition of improvements—reflect lack of maintenance, soundproofing, etc.
- 15 c. Parking—reflect parking rates, adequacy of parking for visitors, proximity of
16 parking to the units, inclusion/exclusion of parking space with unit rental, etc.
- 17 d. Project density—consider open space or crowding of units, if the degree of either is
18 such that it would affect the level of attainable rental.
- 19 e. Unit location—reflect features of location of a unit within the project, such as
20 view, proximity to swimming pool, tennis or other recreational facility, and/or
21 other similar factors.

22 2. Generally, only high-rise elevator comparables are to be compared with the subject
23 elevator high-rise proposal. Mid-floor level rents of the comparables are compared with
24 the mid-floor level of the subject project. Adjustments for heights of the comparables
25 above and below the mid-floor level of the subject also must be made, as indicated by the
26 market.

27 N. Other Income

28 1. Ancillary Income. The appraiser may consider other income based upon the
29 operating history of the project and whether these sources of income are common in
30 the market. Other income might include but is not limited to recurring and reliable
31 sources such as laundry facilities, parking, equipment rental, vending machines, and
32 cable fees The appraiser can consider the net amount of this other income based on
33 the actual or projected (as appropriate) amount received, adjusted for vacancy and

1 income loss. The analysis must be discussed in the Remarks Section of Form HUD-
2 92264.

- 3 2. Commercial Income. The term "Commercial" is applied to any space or facility
4 permitted and acceptable for "Nonresidential Use" from which income is derived or
5 anticipated. Income from residents for the use of facilities such as community rooms
6 and parking are not considered commercial even though fees may be collected. This
7 income is considered ancillary income and is treated separately (as noted above) from
8 commercial income. However, income related to parking or other community
9 facilities from non-residents must be treated as commercial income and is subject to
10 the restrictions on the underwritten occupancy rate as noted in Chapter 3.

11 The space occupied by parking and community facilities is not included in the
12 calculation for allowable commercial space. Non-tenant parking income from
13 commercial parking spaces reserved for use by motorists who are not project
14 residents or are not parking to use the on-site commercial tenant's facilities must be
15 included in the Commercial Space and Income limitations. The income and space
16 attributable to parking spaces reserved for non-residential or non-commercial tenants
17 must be included in the limitations, based on applying the percentage of the total
18 spaces that are reserved for non-tenant use. For existing properties that provide
19 parking for a monthly fee and are to be acquired, refinanced or will undergo
20 substantial rehabilitation, the lender must identify the percentage of monthly parkers
21 who are non-tenants so as to include these in the commercial income limitations. The
22 maximum occupancy factor to be applied to the parking income attributable to
23 parkers who are not associated with either the project's residential or commercial
24 tenants shall be the lower of:

- 25 a. The amount indicated by the market and by the historic performance of the
26 subject, or
27 b. 50 percent

28 **NOTE:** For proposed construction, or where new commercial parking facilities are to
29 be constructed, the demand for this parking must be addressed in the market study,
30 appraisal and underwriter's narrative.

31 If the borrower operates a parking facility that provides parking for residential or
32 commercial tenants of the project, the lender must determine underwritten parking
33 income based on an analysis of the past 3 years of operation and the trailing 12 month
34 period prior to application.

35 If the parking facility is operated by a third-party, the lender may use the amount of
36 income collected under the contract if it is a fixed monthly payment. Parking

- 1 contracts that specify a percentage rent in addition to or in place of a fixed rent are
2 not permitted without a waiver.
- 3 3. Short-Term Lease Premiums. Projects with lease terms that are less than 30 days are
4 not eligible for HUD-insured financing under any circumstances. Income from other
5 short-term leases may be considered to the extent that it exists in the local market.
6 There must be a thorough discussion of the prevalence of short-term leases in both the
7 appraisal and underwriting summary. The amount of the premium is the difference
8 between the rent for a unit with a term that is typical for the market (generally one
9 year) and the rent for a short term lease. This premium is resident-related and is
10 treated as ancillary income. Units with short term leases do not require a separate
11 Form HUD-92273, but the rental amount must be based on market information.
- 12 4. Corporate Leases. Corporations and businesses are eligible residential residents in
13 insured projects, so long as the lease term exceeds 30 days although compliance with
14 the policy on Short-Term Lease Premiums is required. For underwriting and
15 valuation purposes, the percentage of total gross income obtained from corporate
16 leases shall not exceed 10%.
- 17 5. Ineligible Income. Ineligible income should be noted and discussed in both the self-
18 contained appraisal report and the remarks section of the Form HUD-92264. There is
19 no prohibition on this category of income but it cannot be included in the income
20 calculation for the purposes of determining value or the maximum insurable
21 mortgage. Ineligible income includes the following:
- 22 a. Interest Income. The appraiser must not include in the calculation of income any
23 interest income, including interest on reserves.
- 24 b. Ineligible Fee Income. Non-recurring and non-regular income that is not reliable
25 may not be included in the calculation of income. Examples may include, but are
26 not limited to pet fees, pool fees, forfeited security deposits or forfeited rent.
- 27 c. Furnished Units. Furnished units must be underwritten at the same rental rate as
28 unfurnished units. This applies to all units, including those having corporate and
29 short-term leases.
- 30 6. Non-Shelter Services/Elderly Developments. Refer to Section 3.4.S.

31

7.8 Operating Expense Estimates and Determination of Net Operating Income (NOI)

- A. Purpose. The appraiser shall determine the costs to maintain, operate and repair the project and to defray the costs of ownership. An accurate analysis of operating expenses is essential to determining a realistic net income estimate.

Appraisers must use form HUD-92274, Operating Expense Analysis Worksheet, to develop project expense estimates to be included in for Section E of Form HUD-92264, Project Income Analysis and Appraisal. Form HUD-92274 will be prepared for all cases and must be included in the processing file as supporting documentation for Form HUD-92264.

Market expenses attributed to the subject should not be speculative and should bear some reasonable relationship to the project operating history, understanding that some savings in operating expense line items may be gained when proposed repairs are completed. An example of savings might be reduced utility expenses based on the installation of certain energy-efficient features. Reduced real estate taxes based on a new assessment classification would also be justification for estimating operating expenses lower than indicated by the project-specific operating history.

B. Sources of Expense Data.

1. For new construction projects, operating expenses must be estimated on the basis of comparable projects.
2. For existing projects, for both valuation and debt service, operating expenses must be adjusted on the basis of comparable projects, but will primarily be based on the past 3 years of operating experience for the subject project. In addition, the lenders should provide trailing 12 months of income and expenses for the appraiser to compare to the historical statements.
 - a. The most current year project financial statement must have a third party CPA or IPA review. Owner certified financial statements may be submitted for the years prior to the last full Fiscal Year. Any owner-certified financial statement or owner-certified balance sheet and operating statement must include the following acknowledgment:

1 “WARNING: 18 U.S.C. 1001 provides, among other things, that whoever
2 knowingly and willingly makes or uses a document or writing containing any
3 false, fictitious, or fraudulent statement or entry, in any matter within jurisdiction
4 of any department or agency of the United States, shall be fined not more than
5 \$10,000 or imprisoned for not more than five years, or both.”
6

- 7 b. Exceptions. For refinance transactions where the project may not have been
8 under the current ownership for the 3-year period, financial statements for the
9 entire 3 years may not be available. This is particularly true for bankruptcies or
10 the acquisition of defaulted properties. Also, in purchase transactions, not all the
11 required information may be available for reasons beyond the purchaser’s control.
12 In these situations:

- 13
14 i. The borrower must submit a statement through the lender that explains
15 why all the required records cannot be obtained.
16
17 ii. The lender must also certify that they have evaluated the borrower’s
18 statement and agree that the information is not available.
19

20 The Regional Center Director may waive the requirement for past 3-year period
21 financial statements. However, the borrower must submit the project financial
22 statements that are available including an owner-certified year-to-date balance sheet
23 and operating statement.
24

- 25 3. All projects must be analyzed as independent operations and must not reflect shared
26 expenses from nearby projects under the same management, including shared
27 insurance premiums. If the nearby project should be subject to foreclosure, the
28 subject project would be adversely affected, thereby constituting an unacceptable
29 underwriting risk. For the same reason, estimated expenses must reflect typical long-
30 term operation and must not reflect a specific sponsor or management entity whose
31 operation would not be typical.
32

- 33 C. General: Operating expenses are periodic expenses needed to maintain the project and to
34 continue the production of effective gross income. For appraisal purposes, an operating
35 statement that conforms to the above definition of operating expenses may differ from
36 statements prepared for accounting purposes. Current or historic statements must be

1 prepared on a cash basis. It is important to verify the accounting basis for the operating
2 statement, since project operating expenses for appraisal purposes must be reported on a
3 cash basis. Typical categories of expenses are as follows:

4 1. Fixed Expenses. Fixed expenses are those that generally do not vary with occupancy
5 and have to be paid regardless of whether the project is occupied or vacant, and
6 generally do not fluctuate greatly from year to year. Real estate taxes and insurance
7 costs are typically included as fixed expenses.

8 2. Variable Expenses. Variable expenses are operating expenses that vary with the level
9 of occupancy or the intensity of project operation. Operating expenses for large
10 properties frequently list many types of expense variables, but typical broad
11 categories include the following:

- 12 a. Management charges
- 13 b. Utilities – electricity, gas, water, sewer charges
- 14 c. Heating and air conditioning (HVAC)
- 15 d. General payroll and security
- 16 e. Cleaning expenses
- 17 f. Maintenance and repairs
- 18 g. Decorating
- 19 h. Grounds maintenance
- 20 i. Exterminating
- 21 j. Trash removal
- 22 k. Miscellaneous (supplies, etc.).

23 3. Reserve for Replacements. This reserve category provides for the periodic
24 replacement of the building components that wear out more rapidly than the building
25 shell itself and must be replaced periodically during the building's economic life.
26 These components may include but are not limited to roof covering, carpeting,
27 plumbing fixtures, appliances and HVAC. The estimate of the reserve for
28 replacements should be based on reserves that are typically collected for comparable
29 properties in the subject's market area, without regard to FHA programmatic
30 requirements and formulas used for determining the required replacement reserves
31 when calculating debt service coverage. The appraiser must document the research
32 conducted to make this determination.

33 4. Total Operating Expenses. Total operating expenses for residential properties are the
34 sum of the fixed expenses and variable expenses updated to the appraisal date, plus
35 the reserve for replacements.

1
2 5. Commercial Facilities. Where commercial facilities are included in the subject
3 project, a separate analysis must be made to determine the effect that the commercial
4 operation will have on the project expense estimate.

5
6 D. Estimate of operating expenses by units of comparison. Items of expense shown under
7 each comparable and the expense items applicable to the subject proposal must be
8 expressed as suitable unit of comparison—such as expense per unit per annum (PUPA),
9 expense per room per annum (PRPA), and expense per square foot of net rentable area
10 per annum (PSFPA), or percent of effective gross income. The expense comparables and
11 units selected must be as similar as possible to the subject project and units as they relate
12 to the subject location, structural type, number of bedrooms, and average unit size.

13
14 For consistency purposes, expense components must be expressed in the same units of
15 comparison so that the expenses for the subject proposal can be totaled. However, if the
16 unit of comparison for a specific component is different from the basic unit of
17 comparison for the other expense items, this different unit of comparison must be
18 explained in the expense narrative. The dollar amount of the expense item can afterwards
19 be converted to the same unit of comparison selected for the other expense components.
20 Additional documentation must be submitted, as needed, for all component estimates that
21 are not self-explanatory.

22
23 E. Expense Comparables. All insured properties used as expense comparables must be
24 identified and disclosed in the appraiser's Form HUD-92274, expense analysis and in the
25 appraisal, except as noted below.

26
27 1. General Requirements. All comparables (confidential and disclosed) must be
28 representative of the physical and location-specific characteristics of the subject
29 project. Appraisers must always present the best comparables available for their
30 analysis and must refrain from repeatedly using the same disclosed comparable
31 merely to meet the disclosure requirement.

32
33 2. Confidential Expense Data. The appraiser may include confidential expense
34 comparables in the expense analysis, however the analysis must include at least one
35 fully identified and disclosed expense comparable to serve as a benchmark.
36 Appraisers may only use confidential expense comparables that are supportive and

1 consistent with the fully disclosed comparables used in the analysis. When
2 submitting confidential expense comparables, the appraiser must redact only the
3 minimum amount of information necessary to protect the confidentiality of their
4 client. The city, state, and general market area within the city must be disclosed
5 unless this information would clearly identify the comparable and thus breach the
6 appraiser's confidentiality requirement. The project description, unit mix, and the
7 physical characteristics of the comparable's units must be disclosed. It is
8 unacceptable for the appraiser to base conclusions on confidential expense
9 comparables that are not supported by the fully disclosed comparables used in the
10 analysis.

- 11
- 12 3. Review of Insured Expense Comparables. The HRA will compare the FASS or
13 OPIIS systems file for the insured expense comparables used by the appraiser to
14 confirm the data. In order to accomplish this, the HRA will combine the following
15 accounts: Acct. No. 6263T, Administrative Expenses (subtract Acct. No. 6203,
16 Conventions and Meetings, and 6370, Bad Debts), Acct. No. 6400T, Utility
17 Expenses, Acct. No. 6500T, Operating and Maintenance Expenses, and Acct. No.
18 6700T, Taxes and Insurance.

- 19
- 20 F. Expense Adjustments. Project expenses must be expressed in the same units of
21 comparison in order to ensure accurate adjustments and correct reporting of expense
22 estimates. Consistent adjustments for significant differences between the comparables
23 and the subject units shall be derived from the market and applied to the subject expense
24 estimate.

25 The appraiser must enter the dollar amounts attributable to significant differences
26 between the subject proposal and each of the expense comparables—such as for physical
27 characteristics, equipment, services provided, the level of management furnished to
28 residents and any differences in rates between tax and utility jurisdictions. The process
29 of correlation must be used to correlate the comparable expense for each component
30 which is applicable to the subject project.

- 31 G. Updating Procedures. Appraisers must not trend expenses to reflect a time adjustment
32 from the effective date of the most recent expense comparable to the anticipated date of
33 project occupancy following construction and initial endorsement. Instead, expense

1 estimates must be effective as of the date of the appraisal and must reflect the same year
2 of operation.

3 The appraiser may use a factor expressed as a percentage to adjust expense comparables
4 up to the same date as the most current expense comparable in order to make a more
5 creditable comparison. However, if all of the expense comparables have data from the
6 same operating year, no adjustment for updating is necessary.

7 Adjusting expense data is a two stage process, as follows:

8 First, the oldest comparables are updated to the date of the most recent comparable, so
9 that all comparable data is representative of the same effective time period. Second, after
10 updating the comparables to the same effective time period, the line items are correlated
11 and the subject's expense estimate is updated to the date of the appraisal.

- 12 1. The most current comparable is entered in the first column on the HUD 92274. This
13 comparable serves as the benchmark for updating the remaining comparables.
- 14 2. The effective date of the operating expense data is always the beginning date of the
15 operating year, for example the beginning date of a financial statement dated January
16 1st to December 31st is January 1st of that year. If the financial statement fiscal year
17 ends June 30, 2000, the beginning date is July 1, 1999.
- 18 3. Other than the first comparable being the most recent, the remaining comparables do
19 not necessarily need to be in chronological order.
- 20 4. The appraiser must enter the comparable's itemized expenses as reported on audited,
21 reviewed or certified financial statements. Per unit expenses or per square foot
22 expenses are treated similarly:
 - 23 a. The actual expense amount must be entered in the first column, without any
24 adjustments.
 - 25 b. Once the adjusted per unit expenses are determined for each comparable, the
26 subject project's expenses are then correlated from the array.
 - 27 c. Once the correlated line item expenses for the subject project are determined, they
28 are added and updated to the date of the appraisal.
 - 29 d. The correlated subject expenses are updated based upon the beginning date of the
30 expense period of the most recent (the benchmark) comparable. HUD may
31 request from the appraiser the names and addresses of any confidential expense
32 comparables used in the expense analysis, pursuant to the Confidentiality sub-

1 section of the Ethics Rule, along with Standards 3.1.e and 3.2.f of the USPAP. If
2 the appraiser still refuses to provide this information, the HRA may request
3 additional non-confidential comparables.

4 H. The expense line items included in the Section E. of HUD-92264 should be consistent
5 with the individual line items as updated, on the HUD-92274.

- 6 1. Estimate GPI based on in-place rents at the subject property as evidenced by current rent
7 rolls.
- 8 2. Occupancy Standards-Projects must have an average economic occupancy rate of at least
9 85%. Economic occupancy is defined as the effective occupancy level of the project
10 when rent concessions are taken into consideration. For market rate properties, the
11 maximum underwritten economic occupancy rate is 93%. For affordable¹ properties, the
12 maximum underwritten economic occupancy is 97% if a property has: a) at least 90% of
13 units covered by a rental assistance contract, or b) In-place rehab with greater than 90%
14 occupancy and greater than 90% of the units set aside as LIHTC units, with attainable tax
15 credit rents at least 10% below market (i.e. a “discount to market”); 95% if 80% of the
16 units are set aside as LIHTC units, with attainable tax credit rents at a 10% discount to
17 market; and 93% if 100% of the units are LIHTC without a 10% discount to market; or
18 20% or more of the units are market rate.
 - 19 a. Projects must demonstrate a pattern of stable physical occupancy, i.e. the average
20 occupancy standards noted above, for a period of six months prior to submission
21 of the Firm Commitment application, and maintain that occupancy through to the
22 date of Initial/Final Endorsement. Continued occupancy consistent with the
23 underwriting conclusions must be documented with an updated rent roll no more
24 than 30 days prior to closing.

¹ Affordable is defined as: (a) projects that have a recorded regulatory agreement in effect for at least 15 years after final endorsement, (b) projects that meet at least the minimum Low Income Housing Tax Credit (LIHTC) restrictions of 20% of units at 50% of the Area Median Income (AMI), or 40% of units at 60% of AMI, with economic rents (i.e. the portion paid by the tenants) on those units no greater than rents on those units no greater than LIHTC rents, and (c) mixed income projects if the minimum low income unit rent and occupancy restrictions and regulatory agreement meet the above criteria. Projects need not use LIHTCs to qualify for affordable underwriting so long as they have, and are in compliance with, a recorded regulatory agreement imposing the minimum low income occupancy and restricted rent tests in (a), above, and having a term of at least 15 years after final endorsement.

- 1 a. The A piece will be determined by underwriting to the market rent levels over the
2 entire term of the mortgage.
- 3 b. The B piece will be underwritten as the difference between the market rents and
4 the higher Section 8 rents over the remaining term of the HAP Contract.
- 5 3. First-time refinance of a 202 direct loan. Criterion 5 may use the Section 8 HAP rents
6 (even if they exceed the market). Actual project expenses, as evidenced by the three-year
7 operating history as stabilized, will be used. This assumes that these projects are not
8 subject to restructuring under Mark to Market and that no equity will be extracted in the
9 transaction.
- 10 4. Re-refinance of Section 202 direct loans will use the two-tranche method described
11 above. These projects are no longer subject to MAHRA mark to market at the next HAP
12 contract renewal exemptions.
- 13 5. Tax Increment Financing (TIF): The TIF income may be underwritten as a second
14 tranche for the term of the TIF
- 15 6. Low Income Housing Tax Credit Projects (LIHTC). Debt Service rents will be the lower
16 of market or tax credit restricted rents unless there is a Section 8 HAP contract that
17 covers the LIHTC rental units. In the case where there is a Section 8 contract and the
18 tenants will pay no more than the tax credit restricted rents for their portion of the rent;
19 then the lower of market rents or Section 8 rents will be used.
- 20 7. Energy/Utility Efficiencies. Up to 75% of projected savings from energy/utility
21 efficiencies may be underwritten if the projection is based on the CNA e Tool and/or an
22 ASHRAE Level II energy audit, and if the proposed scope of work includes the
23 energy/water efficiency upgrades used in the projections.

24 See Table in Appendix 7 – Criteria for Loan Sizing, for a summary of Exceptions:

25

7.9 Site Analysis

Key analyses for consideration of site acceptability for a proposed project are as follows:

- A. Analysis of Location. The analysis of location involves a determination of the desirability and utility of the site, probable future neighborhood trends, the pattern of project and neighborhood improvements and rents in the area.
- B. Specific Location. Consider the specific site in relation to neighborhood and city-wide physical, social, and economic influences, limitations of use imposed by zoning or deed restrictions, development trends, stability, decay and rehabilitation, availability of utilities, services, and appropriateness of the intended use. Review and analyze the various influences which affect its market and income potential, including a review of the crime rate in the area, its impact on the project and how the impact, if any, can be addressed through design or staffing. (For further guidance, consult USPAP Advisory Opinion 16, “Fair Housing Laws and Appraisal Report Content”).
- C. Civic, Social and Commercial Centers. Consider the sufficiency of community facilities as they relate to the needs of residents of the proposed project. A location for a multifamily project must be adequately served by elementary and secondary schools, neighborhood shopping centers, transportation, churches, playgrounds, parks, libraries, hospitals, and theaters and other appropriate services.
 1. Schools. Accessibility to schools will be judged by the transportation time required, rather than by walking distance alone. Thus, if school bus service will be provided and the time involved is reasonable, the location may be acceptable even if schools are not within walking distance. School capacity is the responsibility of the community and a project that is otherwise feasible will not be rejected because the local schools are considered overcrowded, unless it can be proven that marketability is adversely affected.
 2. Neighborhood Shopping Centers. The convenience of shopping should be judged on the basis of time rather than distance. The importance of grocery, drug, and other neighborhood shopping facilities to be within a reasonable walking distance will be heightened based on the number of residents who do not have private transportation.
 3. Religious and Recreation Centers. Ready access to religious and recreation centers is desirable. Projects designed for large families have a greater need for playgrounds and active recreation areas. Adequate on-site provisions for playgrounds and other recreation amenities must be incorporated into the proposal where adequate facilities are not in close proximity to the project site and available for use by occupants.

1 D. Transportation. Convenient transportation to places of employment, major
2 shopping districts and civic and social centers is a prerequisite to site acceptability.
3 In those communities where local public transportation is the principal means of
4 commuting by the prospective residents, the location of a project designed for such
5 occupancy shall be within a reasonable walking distance to mass transit.

6
7 E. Special Hazards and Nuisances. Such conditions include unusual topography,
8 subsidence, flooding, unstable soils, unusual traffic hazards and noise, danger from
9 fire and explosion, exposure to airport noise and low-flying airplanes, smoke,
10 chemical fumes, noxious odors, stagnant ponds or marshes, and sewage disposal
11 failure. Any of these, or similar conditions, if serious and infeasible to overcome, will
12 cause a specific location to be ineligible for mortgage insurance.

13
14 F. Parking Facilities. The lender and the third party reports must consider the impact
15 that parking requirements for the project will have on parking facilities in the
16 neighborhood and on all-night parking, including the availability of other off-street
17 parking, if the project site lacks adequate parking for residents. The loan proposal
18 must estimate the number of parking spaces that would be required and whether or
19 not the proposed parking facilities will meet the estimated need of the residents
20 and their guests. Convenient access to reliable public transportation may in some
21 cases mitigate parking availability concerns.

22
23 G. Site Suitability. The site must be adequate in size, shape, exposure, and contour
24 for the proposed project. Building height limitation, project unit size and numbers,
25 necessary on-site parking and play areas must be considered.

26
27 H. Sites/Projects Sold by a Public Body.

- 28
29 1. The site value of land in new construction is to be estimated using all
30 applicable approaches to value, as if the project were unrestricted and market
31 rate.

- 1 2. The “As Is” value in substantial rehabilitation cases is to be estimated using all
2 applicable approaches to value based on the current operation of the project
- 3 3. For both 1 and 2 above, no consideration will be given to:
 - 4 a. any additional value that may be attributable to subsidies available to
5 the project or any LIHTCs or other tax benefits the project will
6 receive, or
 - 7 b. any value reduction due to any NOI or value limitations caused by
8 regulatory agreements or affordability restrictions imposed by any
9 subsidy program or tax regulation. This valuation methodology
10 permits sponsors to acquire a project at its market value for new
11 construction or rehabilitation of affordable housing. The value
12 attributable to the presence of LIHTCs diminishes over time and is not
13 always freely transferable, and thus should not be taken into
14 consideration.
- 15 4. The site value of land in new construction or the “As Is” value will be noted in
16 the MAP appraiser’s narrative report and in the Remarks section of the form
17 HUD 92264. For the purpose of developing the cost build-up in Section G of
18 the form HUD 92264, the lesser of market value or the acquisition cost will be
19 entered in Section G. Line 74 (Total Estimated Replacement Cost of the
20 Project) is to be entered in Criterion 3 of the form HUD 92264-A.
- 21 5. **Sites/Projects Sold by a Public Body.** For underwriting purposes, where
22 sites/projects are sold by a public body to the developer for a specific re-use
23 purpose, the value of land fully improved is the lesser of:
 - 24 a. The amount determined by comparison with other sites possessing the
25 improvements and amenities that the subject site will have upon
26 completion.
 - 27 b. The dollar amount paid by the purchaser under the purchase contract with
28 the public body, plus an estimate of any additional costs imposed by its
29 terms or by the insurance program. Such costs are those to be borne by
30 the purchaser under the purchase contract including real estate taxes and
31 special assessments accruing from date of purchase to date of
32 commitment, legal fees incident to the land/project purchase, re-zoning

1 costs, installation of certain designated off-site improvements, razing
2 structures and clearance of the site (after allowance for any income to the
3 purchaser). This is not a complete list of items covered, but serves as a
4 guide to the acceptability of costs required by the purchase contract.

5 c. The actual values are noted in the MAP Appraiser's narrative and in the
6 Remarks Section of the 92264.

7
8 1. "As-Is" Value of Land. HUD's estimated value of land or project "as is" for cost
9 certification may include all of the items in paragraph 1.b above with the following
10 exceptions: Installation of off-site improvements and cost of razing structures and
11 clearing the site (less income received). This is intended to avoid duplication of costs
12 that might be reflected in the estimated value of land "as is" and also allows for the
13 sponsor to include them as separate items in cost certification which includes both
14 off-site costs and demolition. The dollar amount of the land purchase contract plus a
15 breakdown of the estimate of additional costs must be fully itemized and documented.

16 I. Site Value for Subsidized and/or LIHTC Projects: The site value is to be estimated
17 using a capitalization rate and project NOI as if the units and the project were
18 unrestricted and market rate, without considering: a) any additional value that may
19 be attributable to subsidies available to the project or to any LIHTCs or other tax
20 benefits the project will receive, or b) any value reduction due to any NOI or value
21 limitations caused by regulatory agreements or affordability restrictions imposed
22 by any subsidy program or tax regulation. This valuation methodology permits
23 sponsors to acquire project at its market value for new construction or
24 rehabilitation of affordable housing. The value attributable to the presence of
25 LIHTC's diminishes over time and is not always freely transferable, and thus
26 should not be taken into consideration.

27 J. Warehousing of "excess" land area is not encouraged but where un-avoidable, it
28 may be permitted but may not be funded with insured mortgage proceeds.

29

30

7.10 Pre-Application Stage for Sections 220, 221(d) and 231

A. Exhibits:

1. Application for Multifamily Housing Project, Form HUD-92013
2. Location map
3. Phase I ESA with a narrative environmental report. If the Phase I Assessment indicates a need for further study, a Phase II Assessment should also be submitted.
4. Evidence of site control (deed, purchase agreement, or option)
5. Market Study
6. Estimate of Market Rent by Comparison, HUD-92273
7. Photographs and location map of rental comparables used in the HUD-92273 analysis.
8. Operating Expense Analysis Worksheet, HUD-92274
9. Estimate of the warranted price of the land for new construction or the “as is” value of the land and building for substantial rehabilitation cases.

NOTE: The "as is" value of the land and building(s) for substantial rehabilitation cases will be estimated assuming NOI is based on market derived rents and expenses, but reflecting the actual occupancy and pre-rehabilitated condition of the project.

B. Lender's responsibilities:

1. Based upon the market study prepared by the market analyst and the rental income and expense estimates prepared by the appraiser, the lender is responsible for making the following determinations before submitting the application:
 - a. Determine the current occupancy levels, market absorption rates and market demand for the number and type of units proposed.
 - b. Analyze site for acceptability.
 - c. Determine market rents reflecting amenities, services, equipment offered and estimate project income.
 - e. Estimate total operating expenses.
 - f. Estimate mortgage amount based on HUD-92264-A, Criteria 5, and Debt Service Ratio.
 - g. Make a determination of feasibility or non-feasibility of the sponsor's proposal.
 - h. Evaluate the market study and appraisal report. The lender will either accept their

- 1 conclusions for use in underwriting, or may revise them for underwriting
2 purposes. Any such revisions must be explained and justified. The lender may
3 adjust the appraised value downwards but may not adjust it upwards. Once
4 accepted by the lender, and submitted to HUD as part of the lender's application,
5 the lender represents the findings and conclusions of the appraisal.
- 6 2. The Phase I ESA report must be prepared in accordance with Chapter 9 and the
7 lender should advise the market analyst and the appraiser of any conditions which
8 might affect the marketability or value of the project.
- 9 3. The appraiser or market analyst must prepare the market study in accordance with the
10 requirements of this Chapter.
- 11 4. The appraiser must determine project rents, estimated rental income, operating
12 expenses the warranted price of land or "as is" value (of land and buildings for
13 substantial rehabilitation cases). The lender must assure that the forms HUD-92273,
14 Estimate of Market Rent by Comparison, and HUD-92274, Operating Expense
15 Analysis Worksheet, are prepared. For substantial rehabilitation projects, the
16 appraiser must estimate the rents and expenses based on the assumption that all
17 proposed substantial rehabilitation to the project has been completed and is used as
18 the basis for NOI in the debt service criterion.
- 19 5. The lender must consider cost information from various sources, including the sponsor,
20 appraiser, and cost consultant (including soft-cost and land cost information) to calculate
21 the total replacement cost and will compare its estimate of total replacement cost with the
22 costs estimated by the borrower.
- 23 6. Complete the HUD-92264, HUD92264-A, and supporting forms.
- 24 7. The lender must compare the calculations on the HUD-92013 with those proposed by
25 the borrower and either accept the borrower's proposal, recommend its modification,
26 or reject it and advise the borrower that the project is infeasible.
- 27
28

7.11 Firm Commitment Processing for Sections 220, 221(d) and 231 (New Construction)

A. Exhibits:

1. Application for Multifamily Housing Project, Form HUD-92013
2. Evidence of permitted zoning
3. Evidence of last arms-length transaction and price
4. Appraisal
5. Rental Housing Project Income Analysis and Appraisal Form, HUD-92264
6. Supplement to Project Analysis, HUD-92264-A
7. Updated estimates of Market Rent by Comparison, HUD-92273
8. Updated operating Expense Analysis Worksheet, HUD-92274
9. All exhibits for HUD to complete the Environmental Assessment and Complete Findings for the Related Laws (HUD-4128), including any documentation that was required as a result of findings made during Pre-Application processing.

B. Lender's Responsibilities:

1. Contract for an appraisal establishing the replacement cost for the project utilizing the cost approaches in accordance with requirements found in Section 7.6. The appraiser will update the rental and expense analyses provided in the Pre-Application.
2. The appraiser is also required to determine the "warranted price of the land" for new construction projects and the "as is" value of the project for substantial rehabilitation projects. In addition, for Section 231 substantial rehabilitation projects, the appraiser must also determine the "value fully improved" of the project site.
3. The lender must forward or otherwise coordinate sharing information prepared by its cost analyst and any soft-cost and land cost information provided by the sponsor with the appraiser for assistance in the calculation of the total replacement cost.

In accordance with USPAP Standard 2-3, "When a signing appraiser(s) has relied on work done by appraisers and others who do not sign the certification, the signing appraiser is responsible for the decision to rely on their work. The signing appraiser(s) is required to have a reasonable basis for believing that those individuals

- 1 performing the work are competent. The signing appraiser(s) also must have no
2 reason to doubt that the work of those individuals is credible.”
3
- 4 4. The lender must assure that all applicable sections of the Rental Housing Project
5 Income Analysis and Appraisal, form HUD-92264, are completed in accordance with
6 current policy, for the type of project proposed.
- 7 5. HUD-92664 items to be calculated by the appraiser include:
- 8 a. Market rents and estimated income
9 b. Estimated total operating expenses
10 c. Total estimated replacement cost of the project
11 d. “Warranted Price of the Land” for new construction projects and the "As Is" value
12 of the land and building for substantial rehabilitation projects
13 e. Estimate of operating deficit and replacement reserve
14 f. Estimate REL
15 g. Estimate of Interest during Construction (line 53 in section g of Form HUD-
16 92264), to be calculated as the greater of:
- 17 (1) By formula. The amount of the mortgage multiplied by 0.5, multiplied by
18 construction interest rate and multiplied by construction years. (Construction
19 Years is the construction time in months from line 52 in section G of the
20 Form HUD-92264 plus 2 months, then divided by 12)
- 21 (2) Lender’s estimate (optional). The lender’s estimate of interest during
22 construction must be documented with a pro-forma draw schedule or its
23 equivalent, subject to USPAP Standard 3. HUD’s HRAs have the option to
24 modify appraisal conclusions internally or to return the application to the
25 lender for modification. See Chapter 11 Section 11.2 for review by MF
26 Hub/PC staff.
- 27 6. The lender must provide written explanations in the underwriter’s narrative of and
28 major changes to the pre-application invitation letter. Any inconsistency between
29 the data reported on a HUD-92264 prepared by the appraiser and the lender’s
30 HUD-92264 must be explained in the Underwriting
31
32

7.12 Firm Commitment Processing for Section 223(f)

A. Exhibits:

1. Application for Multifamily Housing Project, Form HUD-92013
2. Location map
3. Evidence of permitted zoning
4. Evidence of site control (deed, purchase agreement, option)
5. Evidence of last arms-length transaction and price
6. Phase I ESA with a narrative environment report. A Phase II ESA must also be submitted, should the Phase I ESA disclose a need for further study. This requirement applies to all 223(f) programs and 202 (202/223(f)).
7. Appraisal
8. Rental Housing Project Income Analysis and Appraisal, HUD-92264
9. Supplement to Project Analysis, HUD-92264-A
10. Estimates of Market Rent by Comparison, HUD-92273
11. Operating Expenses Analysis Worksheet, HUD-92274
12. Balance sheets and operating statements
13. Rent roll of the subject project
14. PCNA

B. Lender's responsibilities:

1. The Underwriting Narrative must demonstrate that the MAP Underwriter performed adequate due diligence in reviewing the appraisal which shall include a thorough discussion comparing the appraiser's market analysis to the conclusions from the market study, in cases where a separate market study is required. There must also be a full discussion by the underwriter of the approaches to value and the appraiser's reconciliation and value conclusion.
2. The lender must state any reasons for disagreement with the appraisal report. The underwriting summary should contain a thorough discussion of any differences between the value conclusions made by the appraiser and those conclusions used in underwriting the loan. The appraiser's value conclusions may be adjusted downwards by the underwriter but may not be adjusted upwards.

- 1 3. The appraiser must complete an appraisal of the project establishing market value
2 utilizing the cost, income, and comparable sale approaches. The Cost Approach may
3 be eliminated at the discretion of the appraiser for subjects that are ten or more years
4 old, although an estimate of the land value must still be provided.
- 5 4. The appraiser should where practicable participate in the inspection of the project
6 with the Needs Assessor as described in Appendix 5G.
- 7 5. The appraiser must consider the eligibility of the project, confirm the project
8 occupancy level, and verify the owner's rent roll during the inspection. When the
9 appraiser has established that the owner's rent roll is correct, the actual occupancy,
10 based on the owner's rent roll must be entered in the Remarks Section of Form HUD-
11 92264. The appraiser must also determine whether the apartments are furnished or
12 unfurnished.
- 13 6. The appraiser must analyze the project for acceptability.
- 14 7. The lender must confirm that the Phase I ESA and narrative report is prepared in
15 accordance with all appropriate directives.
- 16 8. The lender must assure that the appraiser completed the forms HUD-92273, Estimate
17 of Market Rents and HUD-92274, Operating Expense Analysis Worksheet. This is
18 based on the determination made by the appraiser of the project's income and
19 operating expenses including a review of the operating history of the project (rent roll
20 and financial statements).
- 21 9. The lender must assure that all applicable sections of the Rental Housing Project
22 Income Analysis and Appraisal, form HUD-92264, are completed in accordance with
23 current policy, for the type of project proposed. HUD-92264 items to be calculated by
24 the appraiser include:
 - 25 a. Market rents and estimated income
 - 26 b. Estimated total operating expenses
 - 27 c. Total estimated replacement cost
 - 28 d. "Warranted Price of the Land"
 - 29 e. Market value of the project
 - 30 f. Estimate of operating deficit and replacement reserve

- 1 g. Estimated and actual occupancy rate
- 2 h. REL
- 3
- 4 9. The data provided in the lender's HUD-92013 and HUD-92264 must be consistent
- 5 and any inconsistency between the data reported on a HUD-92264 prepared by the
- 6 appraiser and the lender's HUD-92264 must be explained in the Underwriting
- 7 Summary.
- 8
- 9 10. The lender must assure that the Remarks Section of HUD-92264 contains the
- 10 following information:
- 11
- 12 a. The appraiser's statement of actual occupancy, based on the owner's rent
- 13 roll.
- 14 b. The required amount of initial deposit into the Reserve for Replacement.
- 15 c. The estimated cost of required repairs as provided in the inspection report.
- 16 d. The estimated amounts for legal, organizational (if applicable), title and
- 17 recording expenses based on the maximum insurable loan.
- 18

19 **7.13 Substantial Rehabilitation Processing for Sections 220,**

20 **221(d)(4) and 231**

- 21 A. In general, a substantial rehabilitation project is processed in accordance with the
- 22 instructions found in Sections 7.10 and 7.11, except as noted below.
- 23 B. Form HUD-92264 must be completed in accordance with basic valuation instructions for
- 24 Sections 221(d) and 220 processing, with the following modifications:
- 25 1. "As Is" Value. Development of the "As Is" value must be in accordance with the
- 26 pertinent requirements of Standards 1 and 2 and the applicable approaches to value.
- 27 A supplemental HUD 92264 is not required.
- 28 2. The HUD-92273 and HUD-92274 analysis used to support the income and expenses
- 29 on the HUD-92264 must reflect the "as completed" project conditions that will exist
- 30 after substantial rehabilitation has taken place.
- 31 3. A value for the land without improvements must be estimated and entered using the
- 32 analysis grid in Section H of the HUD 92264.

1 4. The “as is” value and the value of the land without improvements must be entered in
2 Section “O” (Remarks) of the HUD 92264.

3
4 C. Applicable Approaches - "As Is" Value in Substantial Rehabilitation: The estimate of
5 “As Is” value of the land and building before rehabilitation should be estimated by the
6 direct market comparison approach and the income approach to value. The “As Is” value
7 by the residual approach is not mandatory, but can be used in cases where there is a lack
8 of market sales. The Market Value by the market comparison approach will be based
9 upon market prices for comparable properties in similar condition, and level of occupancy
10 after adjustment, to the project being appraised. The income approach may not be feasible
11 for the valuation of properties in extremely poor condition or are mostly or entirely vacant,
12 boarded up or abandoned for an extended period to time.

13 D. Valuation Processing: (Sections 220, 221(d)(3), 221(d)(4))

- 14 1. Determine the market value of the project "As Is". Complete the Location and
15 Description of the Project, Information concerning Land or Project, Estimate of
16 Income, Equipment and Services Provided in Rent, Estimate of Annual Expenses,
17 Income Computations, and Income Approach to Value, and Sales Comparison
18 Approach to Value within the report. If the project involves rehabilitation and new
19 construction with additional land to be added, also complete a land appraisal for that
20 portion of the land to be added for the new construction portion of the development
21 proposal.
- 22 2. Use the Replacement Cost by Formula, Rehab Projects, with or without BSPRA, to
23 find the total project cost (summation estimate) using the "As Is" market value of the
24 project, and the rehabilitation cost estimate furnished by the cost analyst, plus
25 carrying charges and financing.
- 26 3. Complete HUD-92264. In Section G, the "As Is" market value of the project before
27 rehabilitation will be shown on the line titled "As Is" value of project except as noted
28 below.
- 29 4. "As Is" value of project acquired as a leasehold estate. Instructions for limiting the
30 “As Is” value of project before rehabilitation, when that project is acquired as a
31 leasehold estate, are found in Ground Leases, Section 7.16.
- 32 5. To find the project mortgage amount for Section 220 and Section 221, use the lower
33 of Criteria 1, 3, 4, or 5 on HUD-92264-A. Estimate the "As Is" value of the project
34 before rehabilitation, add the total for all improvements plus soft costs to the As-Is
35 Value to obtain the sum of the above costs. Then multiply the sum of the project
36 costs listed above by 90 percent based upon Criterion 3 to obtain the maximum
37 project mortgage amount. Under the Section 221(d) (3) program for nonprofit
38 borrowers, multiply 90 percent against the sum of the project’s cost.

1 **NOTE:** Cost Certification instructions (enforced by Statute) dictate that the **lesser** of
2 the “as is” value of the land and improvements (before repair or rehabilitation) **or** the
3 purchase price of the land and improvements, is used in the cost build up for criterion
4 3 of form HUD 92264A, in substantial rehabilitation cases. Consequently when
5 mortgage proceeds will be used to fund the acquisition of the project, the “as is” value
6 estimation will be used as a test of the reasonableness of the acquisition price.

7 When the acquisition price is less than the “as is” value of the land and improvements
8 (as accepted by HUD), and mortgage proceeds will be used to fund the acquisition of
9 the project, the acquisition price will be used in the cost build up for criterion 3
10 forming the cost basis for the firm commitment

11 When the acquisition price exceeds the “as is” value of the land and improvements
12 (as accepted by HUD), then the acquisition price must be reduced to the “as is” value
13 and will, subsequently, comprise the basis of the cost build up for the firm
14 commitment.

15 When mortgage proceeds will **not** be used to fund the acquisition of the project, the
16 “as is” market value of the project will be used in the cost build up for criterion 3
17 forming the cost basis for the firm commitment. This is particularly significant when
18 below market rent restrictions, (such as in the case of LIHTC limited rents or Section
19 8 rent subsidy) are in place and the use of market rents in valuing the project will
20 result in a premium over these rent restrictions. (See Section 7.10 A 9, defining how
21 market rents are derived as the basis for the “as is” value)

22
23 E. Valuation Processing for Section 231 Substantial Rehabilitation Cases. Section 231
24 substantial rehabilitation cases requires two value estimates, a value subject to the
25 completion of rehabilitation using all applicable approaches, which shall be used in
26 Criterion 3 of the Form HUD-92264-A, and an “As Is” value entered in Section G, line
27 73b of the Form HUD-92264 to determine the Total Replacement Cost of the Project, in a
28 manner similar to the procedure used in Sections 220 and 221(d) (3 & 4). Depreciation is
29 not included. The “As Is” value is also used in completing Criterion 6 of the Form HUD-
30 92264-A.

31 If the Total Estimate Replacement Cost of the Project (Line 74 of Section G of the
32 92264) exceeds the value after rehabilitation, the residual “As Is” value by formula must
33 be completed. This amount must be entered on line 73b of Section G, and Section G, line
34 74 will be considered to be the value of the project after rehabilitation and this amount
35 must be entered in Criterion 3 of the Form HUD-92264-A.

36 F. Contingency Reserves. To address unanticipated costs inherent in the rehabilitation of
37 older structures, there will normally be included in the mortgage amount a reserve for

1 contingencies based on the percentage of estimated rehabilitation cost without fees. This
2 percent may range between 10 and 15 percent, depending upon the scope and type of
3 rehabilitation and the experience and financial ability of the sponsor, the borrower and
4 contractor and on whether the contractor's bid already contains a reserve for
5 contingencies. This percentage, determined by the cost analyst, must be included as a
6 separate line item in the estimate of replacement cost on HUD-92264.

7 G. Interest during Construction. Interest during construction in either new construction or
8 substantial rehabilitation (line 53 in section G of Form HUD 92264) must be calculated
9 as the greater of:

10 1. By Formula. The amount of the mortgage multiplied by 50 percent, multiplied by
11 construction interest rate and multiplied by construction years. (Construction Years is
12 the construction time in months from line 52 in section G of Form HUD-92264 plus 2
13 months, then divided by 12).

14 2. Lender's Estimate (optional). The lender's estimate of interest during construction
15 must be documented with a pro-forma draw schedule or equivalent.

16 H. Inspection Fee. The inspection fee is calculated as half of one percent (0.5%) of the loan
17 amount when the project involves new construction. For substantial rehabilitation
18 projects, the inspection fee is calculated as the sum of Total for All Improvements (plus
19 BSPRA, if applicable), times one half of one percent (0.5%) rounded to the next higher
20 \$100.

21 I. Offsite costs. If there are any offsite costs associated with the rehabilitation, enter them
22 as a line item in the Estimated Replacement Cost. This separate entry is necessary in
23 rehabilitation processing, since the "As Is" value does not include offsite cost
24 requirements.

25 J. Rehabilitation cost not attributable to residential use. This entry must be completed for
26 all rehabilitation projects and is prepared on Rehabilitation Cost Not Attributable to
27 Residential Use, found in the MAP Form Book, and transferred to line 4b under Criterion
28 4, Amount Based on Limitations per Family Unit, HUD-92264A.

29 K. Developer's Fee, when applicable. HUD may include in the estimated replacement cost
30 of a project, a nonprofit developer's fee in addition to the legal, organizational and audit
31 fees normally included in the estimated replacement cost of a project. These instructions
32 do not apply to the refinancing of Section 202/811 projects.

33 1. The fee will be based on a sliding scale at eight percent of the mortgage, but not less
34 than \$40,000 or more than \$400,000.

- 1 2. Exceptions:
- 2 a. For mortgages in excess of \$5,000,000 increase the maximum fee to provide an
- 3 additional 2 percent based on that portion of the mortgage that is in excess of
- 4 \$5,000,000.
- 5 b. At the option of the nonprofit sponsor/borrower, the fee included in the
- 6 replacement cost may be reduced.
- 7 3. Part or the entire fee may be used to pay for transactional costs related to developing
- 8 the subject project including but not limited to:
- 9 a. Reduction of the estimated closing costs of the project
- 10 b. Staff salaries
- 11 c. Nonprofit working capital deposit
- 12 d. Relocation expenses
- 13 e. Operating deficit escrow
- 14 f. Financing fees above the 3.5 percent included in the estimated replacement cost
- 15 of the project;
- 16 g. Environmental studies
- 17 h. Housing Consultant services provided by either in-house staff or contractor
- 18 4. Funds not used to meet the estimated cash requirements of the project will be released
- 19 to the nonprofit based on a percentage of completion method.
- 20
- 21 L. Items no longer included in the Estimated Replacement Cost of a Project. HUD will no
- 22 longer include in the estimated replacement cost of a project, an Allowance to Make
- 23 Project Operational (AMPO) and an amount for Housing Consultant services except as
- 24 part of the developers fee noted above.

25

7.14 Calculating Operating Deficits

A. Estimate of a Project's Operating Deficit. When it is anticipated that the project's net income will be inadequate to support the insured loan during the initial rent-up period, the appraiser must estimate the anticipated project operating deficit, utilizing the following steps:

1. Estimate the total project operating expenses, add the debt service requirement (including principal, interest and mortgage insurance premium (MIP)) and divide the total by the potential gross income for the project. The resultant ratio is the break-even occupancy level. Multiply that percentage times the total project units to obtain the number of units required for break-even occupancy (rounding up any fraction of a unit).
2. Estimate the total number of units expected to be occupied at the time of Final Endorsement. The difference between the total units required for break-even occupancy and those occupied units at the time of Final Endorsement represent the total number of units that must be rented in order to reach a break-even occupancy level.
3. Estimate the likely rate of absorption of the available units, taking into account the current and proposed supply of housing units in the subject's market balanced against demographic and demand considerations. The absorption or lease-up rate must be supported by comparison to similar project's historic rates of absorption during their lease-up period whenever such a comparison can be made. The number of units to be absorbed, divided by the monthly absorption rate, will yield the total number of months of the entire operating deficit period.
 - a. Absorption Period. The Absorption Period is the period of time necessary for a newly constructed or renovated project to achieve stabilized occupancy. The absorption period begins when the first certificate of occupancy is issued and ends when the last unit to reach stabilized occupancy has a signed lease and is actually occupied by a resident. A typical pre-marketing period begins about three to six months prior to the issuance of the certificate of occupancy, therefore the month that leasing is assumed to begin should accompany all absorption estimates. It is

1 important to consider that the absorption of restricted/low-income units
2 may be different, depending on the differential in rent between low-
3 income rents and market rents, and the number of income-qualified
4 potential residents in the HMA.

5 b. Maximum Allowable Absorption Period. As a result of risk mitigation
6 guidance, the absorption period used in estimating market demand for the
7 proposed number of units has been reduced from 24 to 18 months. Larger
8 projects may phase additional units under a separate application for
9 mortgage insurance (e.g. under Section 241(a)). An exception to the 18-
10 month absorption period limitation may be waived by the Regional Center
11 Director for large high-rise buildings. Such projects will be evaluated
12 based on their own merit and will require a larger initial operating reserve
13 to insure against the risk inherent in a longer absorption period.

14 c. Absorption Rate. The Absorption Rate is the average number of units
15 rented each month during the absorption period.

16 4. Because the deficit period can begin at certificate of occupancy and continue
17 through the cost certification phase and the amortization phase, there are three
18 distinct expense intervals to consider when calculating the total deficit period,
19 although not every project will require using all three intervals.

20 **Interval 1** covers the period of time between certificate of occupancy and
21 the end of the construction period/cost certification period. (Note that the
22 construction period is defined as construction time plus two months for
23 cost certification purposes). This is an optional interval, because some
24 projects may have the same certificate of occupancy and construction
25 completion dates and thus would not need an Interval 1. When calculating
26 expenses for this Interval, no debt service is to be included as an expense
27 since the mortgage interest for this interval is included in the mortgage in
28 Section G Line 53 "Construction Interest". Replacement Reserves and
29 ground rent are not to be included in Interval 1 since Section 7.16.G
30 requires ground rent during the construction period to be included in the
31 mortgage. This interval must only include the appraiser's estimate of all of
32 the applicable operating and leasing expenses for each month (period).

33 **Interval 2** begins at the end of the construction period/cost certification
34 process (construction time plus two months) and ends at the beginning of

1 loan principal amortization. This period can be no greater than 2 months
2 and is also an optional interval. (Chapter 8 Section 8.5.A requires
3 amortization to begin "no later than 4 months after construction
4 completion for insurance of advances and first day of second month after
5 final endorsement for insurance of completion cases"). If amortization
6 begins at the end of the construction period, this interval will not be
7 necessary. Debt service must include payment of interest and MIP, but
8 not amortization, as the beginning of amortization signals the beginning of
9 Interval 3. (Section G Line 53 of the HUD-92264 includes mortgage
10 interest for the construction period plus two months. If amortization is
11 deferred until 4 months after construction completion, there will be two
12 months of unaccounted-for interest and MIP that must be included in the
13 IOD). Ground rent must be included if the project is a leasehold since
14 only ground rent during construction can be included in the mortgage, and
15 this interval begins after construction completion. Replacement reserves
16 are not included in interval 2. This interval must include the appraiser's
17 estimate of applicable operating expenses for each month (period).

18 **Interval 3** begins at the beginning of amortization. Amortized debt
19 service is mandatory in this interval, and must include payment to
20 principal, interest and MIP. Ground rent, if applicable and replacement
21 reserves are also mandatory in interval 3. This interval must include the
22 appraiser's estimate of applicable operating expenses for each month
23 (period). Interval 3 ends when NOI becomes positive and is sufficient for
24 breakeven coverage of the mortgage debt.

- 25 5. Operating deficits can occur before and after the start of amortization. The operating
26 deficit calculation for the first interval must begin when the Certificate of Occupancy
27 is secured.
- 28 6. If the dollar amount of debt service for a period is greater than the net income for that
29 period, the difference represents the estimate of the operating deficit. One period of
30 positive income does not cancel a prior period of income deficiency.
- 31 7. The operating deficit represents the total of all cumulative losses projected to occur
32 before the project reaches breaks even and produces a positive cash flow. These losses
33 may not be offset by intermittent periods of positive cash flow.

- 34 B. Where commercial facilities are included in the project, a separate operating deficit
35 estimate of income loss for commercial rent-up must be prepared. The appraiser must
36 insure that expenses included in the residential deficit estimate are not duplicated in the

1 commercial space deficit estimate so as to unfairly penalize the project. The commercial
2 space deficit is added to the residential operating income deficit to determine the total
3 project operating deficit escrow funding that will be necessary. Any positive income
4 attributable to the commercial space during the deficit period will not offset the
5 residential operating deficit requirements.

6

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7.15

Leaseholds/Ground Leases

1
2 A. HUD prefers to only insure mortgages for project that is owned in fee simple. For those
3 transactions, in which fee simple ownership is not practical and a leasehold estate is
4 proposed, the leasehold estate must be marketable. the underwriting and valuation
5 guidance in this section applies. Note: It is important that all reviewers have an
6 understanding of ownership interest in a lease transaction and their related values.

7 **NOTE:** HUD will consider a leasehold estate consisting of land and improvements.
8 Changes to the standard lease form addendum will only be considered where the
9 owner/lessor is a public/government entity.

10 When used in this section, the words and terms below are defined as follows:

- 11 1. Fee Simple Estate- represents the entire ownership, from beneath the soil to the
12 air above, enduring by inheritance and indefinitely into the future, typically
13 subject to taxation and eminent domain.
- 14 2. Leasehold Estate- is the interest of the lessee under a lease for a term of years.
15 When the term of the lease expires, all rights to possession and use revert back to
16 the lessor/fee simple owner and the leasehold estate terminates. A leasehold
17 estate can involve both land only or land and improvements
- 18 3. Leased Fee- Is the interest of the lessor/fee simple owner during the period when
19 the project is under lease.
- 20 4. Lease- a written contract between an owner (the lessor) and a resident (the lessee)
21 with the conditions under which the lessor will transfer the use of real project to
22 the lessee in return for lease payments or rent.
- 23 5. Ground Lease- a long term agreement by which an owner of land (lessor) leases
24 an unimproved, site to a resident (lessee) for a term of years.
- 25 6. Ground Rent- is payments on a ground lease and must bear a reasonable
26 relationship to the value of the site "As Is" (before construction of on-site or off-
27 site improvements) unless the ground lease is from a governmental agency which
28 has made the ground lease available for limited ground rent to support the

- 1 development of affordable housing.
- 2 7. Leasehold Improvements- are improvements or additions to leased project that
3 have been made by the lessee.
- 4 8. Gross Collections (or effective gross income) - is the annual amount collected
5 from all sources, less refunds.
- 6 9. Operating Expenses (residential and commercial)- include items in accord with
7 Generally Accepted Accounting Principles. Operating expenses must include the
8 annual amounts deposited to the Reserve for Replacement. Operating expenses
9 shall not include interest charges, or charges or allowances for depreciation of real
10 or personal project, or amortization of financing expense, or payments to any
11 officer or director of the corporation, unless such payments are for services at the
12 project which are necessary to the operation of the project.
- 13 10. Taxes- shall include project taxes and special assessments. Taxes shall not
14 include income taxes. Net income before debt service payments shall mean the
15 annual amount which remains after operating expenses and taxes are subtracted
16 from effective gross income.
- 17 11. Debt service payments- shall be the annual amounts paid to mortgage principal,
18 interest, and MIP.
- 19 12. Net cash flow- shall be the annual amount remaining after debt service payments
20 are subtracted from net income.

21 B. Lease Requirements

- 22 a. Lease Term-
- 23 a. For Section 220 and Section 221(d), the term must be (1) for not less than 99
24 years which is renewable, or (2) under a lease having a period of not less than
25 ten years to run beyond the maturity date of the mortgage.
- 26 b. For Section 207/223(f) and Section 231, the lease term must satisfy one of the
27 following requirements; (1) a lease term for not less than 99 years which is
28 renewable, or (2) a lease having a period of not less than 50 years to run from
29 the date the mortgage is executed.

1 Note: When a lease is on trust/other land on a reservation, the HUD closing attorney
2 must ensure that the lease provisions are coordinated with Bureau of Indian Affairs
3 requirements.

4 C. Legal Review- The ground lease must receive both a legal and a lender
5 underwriting review, neither of which may be substituted for the other. HUD's
6 legal review shall establish that the proposed lease is in conformity with the
7 applicable statute, regulations, Form HUD-92070M (the Lease Addendum model
8 form), and applicable provisions of local law. Any deviations from Form HUD-
9 92070M must be approved by Headquarters' Office of Multifamily Housing
10 Production and supported by a complete underwriting analysis by the lender and
11 reviewed by the HUD field office recommending approval. Local Counsel must
12 approve: (1) the legal need for any proposed lease term changes, and (2) that any
13 term changes are consistent with the following requirements of the Section of the
14 Act under which the project is underwritten. This documentation is necessary
15 when referring requested changes to HQ. Exceptions for the need for HQ
16 approval are as follows.

- 17 a. **In cases where the lessor is a public entity or housing authority,**
18 Headquarters Director of Multifamily Production may waive the right of the
19 Secretary to purchase the fee in the event of default.
- 20 b. In cases where both land and improvements are to be leased by a public entity
21 or housing authority, the following instructions relating to modifying the lease
22 addendum apply:
- 23 1) The second paragraph of the document (immediately above "LEASE
24 ADDENDUM") may be stricken from the document, provided the lease is
25 otherwise eligible for use in the FHA multifamily mortgage insurance
26 programs under the National Housing Act, i.e., it is a mortgageable real
27 project interest under state law and conforms to the statutory requirements for
28 duration.

- 1 2) The first paragraph of the document, under “INSTRUCTIONS FOR
2 LEASEHOLD PROJECTS”, is still applicable in this context and may not be
3 deleted.
- 4 3) Certain definitions in the form must be revised to accurately describe the
5 entirety of the project making up the leasehold estate. Namely, the definition
6 of “Improvements” should be stricken, along with any additional use of this
7 word when referencing this formerly defined term.
- 8 4) A definition of “Project” must be included, as well as amended from the
9 current definition to include the land buildings and improvements (and
10 fixtures), so that “Project” is defined “as the legally described land, in addition
11 to all buildings, fixtures, structures, alterations or other improvements and
12 fixtures now constructed or at any time in the future constructed or placed
13 upon the land, including any future replacements and additions hereafter
14 located thereon.” This revised definition of “Project” should be included as a
15 footnote to the first use of the word in the first paragraph under “LEASE
16 ADDENDUM”.
- 17 5) Any reference to “ground” (when immediately preceding “lease”) throughout
18 the document may be stricken, so that the document refers to a “lease” and not
19 a “ground lease.”

20 **NOTE:** The above provisions pertaining situations where the lease involves both
21 building and improvements apply to projects that are affordable. This is not
22 permitted for market rate projects.

- 23 c. **Air Rights.** For projects involving air rights, local counsel may modify the
24 addendum as necessary to account for this form of ownership.
- 25 D. **Option Price for the Federal Housing Commissioner.** The ground lease must contain an
26 option for the Federal Housing Commissioner to buy out the lease. The option price
27 contained in the lease addendum must reflect the value of the leased fee in Form HUD-
28 92264 in affect at the time of Firm Commitment.
- 29 E. **Regulation for Leaseholds-** HUD regulations state “Reduced mortgage amount -
30 leaseholds. In the event the mortgage is secured by a leasehold estate rather than a fee
31 simple estate, the value or replacement cost of the project described in the mortgage shall
32 be the value or replacement cost of the leasehold estate (as determined by HUD) which

1 shall in all cases be less than the value or replacement cost of the project in fee simple.

2 F. Unacceptable Lease Payments- Some variable lease payments may not be acceptable
3 because they raise the risk that future payments may be too burdensome and may cause a
4 potential default in the mortgage payments. Examples of unacceptable methods of
5 determining variable ground rents are: a graduated schedule of future increases on a lump
6 sum year-by-year basis, Cost of Living Allowance (COLA) increases, and increases
7 based on the results of future appraisals.

8 G. Acceptability of Lease Payments. To determine if the initial amounts are within
9 underwriting limitations, ground rents may be computed using any of the following three
10 methods:

11 a. A fixed percentage of gross collections (or effective gross income). The percentage
12 must remain the same throughout the term of the lease.

13 b. A fixed percentage of net cash flow to equity (after debt service payments but before
14 lease payments). The percentage must remain the same throughout the term of the
15 lease.

16 c. A stated dollar amount per year which must remain fixed for at least ten years more
17 than the term of the insured mortgage. (If monthly or quarterly payments are
18 required, these will be converted to annual amounts by the appraiser). When the lease
19 contains more than one method of computing lease payments, it must also indicate
20 whether the amount to be paid is to be the greatest or the least, or the sum of these
21 amounts. The stated annual dollar amount may be described as a minimum payment.

22 d. The MAP appraiser must estimate the lease payments, using the lump sum annual
23 amounts and percentages contained in the lease provisions, as applied to the estimated
24 annual effective gross income or annual cash flow indicated by the appraisal and on
25 Form HUD-92264. (The estimates are not based on the income which would be
26 available during any period of deficit operation, but must reflect the effective gross
27 income shown on Form HUD-92264 and the corresponding cash flow to equity which
28 result when sustaining occupancy has been reached.).

29 H. Valuation Instructions.

30 1. **For projects that involve a ground lease without an option to buy**, the Department
31 will not insure a loan that will recognize a leasehold interest for security. For this reason,

1 the value of the site “as is” will be entered by the MAP Underwriter on lines 3.b.(1) and
2 4.f on the form HUD 92264-A named “Value of the Leased Fee”. This is to be done
3 regardless of whether the ground rent is an escalating amount based on a percentage of
4 gross collections or cash flow, or whether it is a level stated dollar amount each year.

5 **NOTE:** These instructions are included only for underwriting and loan sizing purposes.
6 The actual value of the leased fee is estimated by capitalization of the ground rent in
7 section K-6 on the form HUD 92264.

8 2. **For projects involving a ground lease containing an option to buy**, the value of the leased
9 fee may be estimated by capitalizing the ground rent. The following conditions apply:

- 10 a. The lease must give the lessee an option to buy the site in fee simple for a stated
11 purchase price at some time during the term of the lease.
- 12 b. This stated purchase price must be provided in the ground lease and may not
13 exceed the value of the fee estimated by the capitalization method of value at the
14 time of project appraisal.
- 15 c. The annual ground rent required by the lease must be level payments of a stated
16 dollar amount and must remain unchanged from the date of mortgage
17 endorsement to at least ten years after the mortgage term.

18 3. **For projects involving a lease on both land and improvements:**

- 19 a. The lessor must be a governmental body or housing authority. The units must be
20 100% affordable. There are no exceptions and no waivers at the Hub level.
- 21 b. The project interests to be appraised are “fee simple” and “leased fee.”
- 22 c. There must be a thorough discussion in the appraisal and underwriting narrative
23 regarding the lease terms and a determination that the leasehold estate is
24 marketable.
- 25 d. The fee simple determination must be made based in compliance with the current
26 MAP Guide
- 27 e. The Department will permit the use of Discounted Cash Flow analysis and/or
28 Direct Capitalization of the or in determining the value of the leased fee. There
29 must be a thorough discussion of the parameters used and how the discount rate
30 was derived.

- 1 f. The value of the leasehold will be accounted for on the form HUD 92264A by
2 subtracting the value of the leased fee as appropriate in Criteria 3, and 4.
- 3 4. **Ground Leased from Public Bodies.** On sites leased by a governmental body to a
4 developer for use for a specific purpose, the procedures outlined in this chapter remain
5 unchanged, except that the "As Is" market value of the site, vacant or improved, in fee
6 simple may not exceed the value of the leased fee.
- 7 5. **Rehabilitation of an Existing Leasehold Project (Leasehold Improvements owned by**
8 **the mortgagor).** When a leasehold estate contains existing buildings and is to receive an
9 insured mortgage for substantial rehabilitation, valuation processing will vary from fee
10 simple rehabilitation processing as follows:
- 11 a. Tentative "As Is" value of both land and building(s) must be established by
12 capitalization of income and by comparable sales. The Cost Approach may be
13 used where buildings are in extremely poor condition and/or vacant.
- 14 b. Value of the land without building improvements must be made by market
15 comparison based on sales of similar sites.
- 16 c. Acquisition Cost of Buildings. Since the value of the land without improvements
17 does not include buildings, the cost of the acquisition of the buildings will be
18 whatever added cash amount the buyer pays the seller of the subject project for
19 the buildings, net of land, at or before initial closing. A certificate of the
20 separately agreed amount for purchase of the buildings must be submitted with
21 the application exhibits. In a refinancing loan which does not involve a buyer and
22 seller, the cost of the buildings may not exceed the remaining mortgage balance.
- 23 d. Final "As Is" value of entire project is the lesser of Tentative "As Is" Value or the
24 sum of Value of Land without Building Improvements and Acquisition Cost of
25 Buildings. Value of the Leased Fee is considered to be the Value of Land without
26 Building Improvements. The value of the leased fee must be estimated to equal
27 the value of the site in fee without the on-site improvements and is entered on
28 Line K-6 of Form HUD-92264.
- 29 E. Other Provisions:
- 30 1. Ground Rent during Construction. For proposed construction under all FHA
31 insurance programs, lease payments during construction must be included in the

1 estimated replacement cost of the project and in the certified cost, subject to the
2 following conditions:

- 3 a. The period for which ground rent is estimated must be the same as that for which
4 interest and other related charges are calculated, or, the estimated construction
5 time plus two months.
- 6 b. Ground rent during construction must be entered in Line G 69 of Form HUD-
7 92264 (currently labeled “Construction Fee.”). A remark must be entered in
8 Section H, indicating that the amount in Line G 69 represents Ground Rent during
9 Construction.
- 10 c. Ground rent must not be included in the base on which Section 220, 221(d)
11 BSPRA is calculated.
- 12 d. The annual amount of ground rent during construction may not exceed the test for
13 acceptability of lease payments.
- 14 e. For rehabilitation under all Sections of the Act, ground rent during rehabilitation
15 must be included in the replacement cost.

- 16 2. Replacement Cost by Formula. A formula that will provide the total project
17 replacement cost and mortgage amount, based on cost for substantial rehabilitation
18 wherein a leasehold estate is involved, is shown in the MAP Forms Book. This
19 formula provides both for sections of the act which recognize and which do not
20 recognize BSPRA.

22 **7.16 Tax Abatement Procedures**

- 23 A. General Comments and Exceptions. Tax Abatement is a reduction of project taxes for a
24 specified term by the taxing authority. Properties with abatement are eligible for
25 additional mortgage funds under certain circumstances. The abatement must run with the
26 real estate and not with the type of sponsorship if it is to secure additional mortgage
27 proceeds, otherwise underwriting must include an amount for project taxes in project
28 operating expenses even if the present owner or its transferee may not pay them. The risk
29 that a transferee of the project or an assignee of the mortgage in the future might cause
30 the tax abatement to be lost is an unacceptable risk to the insurance fund. Exceptions to
31 these requirements include the following:

- 1 1. If the financing includes LIHTC equity and if the tax abatement runs with the
2 sponsorship (borrower) entity, then the Regional Center Director may waive the
3 MAP Guide so that the underwriting does not have to include a provision for
4 project taxes during the period of the tax abatement. This exception is justified
5 for low loan-to-value mortgages on LIHTC projects and the additional due
6 diligence and oversight by private equity investors.
- 7 2. Properties leased from a governmental body to either a non-profit or for-profit
8 developer, where the project is exempt from taxes and the abatement flows to the
9 leasehold improvements. There is usually a requirement for a percentage of units
10 to be set aside as affordable housing which is imposed by a land use restriction or
11 regulatory agreement. Regional Center Directors may grant a waiver, after
12 appropriate review, to promote affordable housing.
- 13 B. Long Term Tax Abatement. If the amount of the tax abatement is fixed and runs the
14 entire term of the mortgage, the real estate tax expense reported on the HUD-92264 must
15 be the actual amount of taxes the project will pay, if any. The full amount of the real
16 estate taxes without the abatement must be noted in the remarks section of the HUD-
17 92264. The project will benefit from an increased mortgage amount due to the lower pro-
18 forma operating expenses and an increased NOI estimate. When the abatement runs for
19 the full term of the mortgage, the NOI used for Form HUD-92264-A Criteria 5 may also
20 be processed at the reduced tax amount. Also, if value attributable to long term tax
21 abatement is recognized in the subject's market area, the same NOI may be capitalized
22 and the resulting value may be used in Criterion 3.
- 23 C. Short Term or Variable Tax Abatement. If the abatement is short term or variable, it may
24 still be used to secure additional mortgage proceeds. The additional mortgage will be the
25 amount that will amortize over the term of the tax abatement. A special amortization
26 plan must be requested which has debt service payments that are increased by the
27 additional net income generated during the term of the abatement. When processing a
28 short term or variable abatement, the full amount of the project taxes must be estimated
29 and included in the total project expenses on Form HUD-92264 as if there were no
30 abatement. The additional debt service carry resulting from the abatement must be
31 calculated on line I, Criteria 5 of HUD-92264-A.
- 32 If Criteria 5, "Amount Based on Debt Service Ratio" is not the controlling criterion, short
33 term or variable abatements cannot be used to secure additional mortgage proceeds.

1 Also, the appraiser must not include extra value associated with short-term abatement in
2 either the estimate of land value, the “As Is” value for substantial rehabilitation or the
3 “As Repaired” value for existing projects, and it may not be included in Criterion 3.

- 4 1. Short Term Abatements: Assume that Project A has been awarded a 5-year tax
5 abatement of \$5,000/year and the interest rate on the insured loan is quoted at 7.5%
6 and the MIP is 0.5%. The amount of additional mortgage is calculated by dividing
7 the annual abatement, \$5,000 by the applicable debt service rate (P, I, and MIP). In
8 this example the debt service rate is 0.245455383.

9
$$\$5,000 / .245455383 = \$20,370$$

10 Additional mortgage amount. The mortgage amount based upon debt service
11 (Criteria 5 of HUD-92264-A) would be increased by \$20,370 and a special
12 amortization schedule would be required with a debt service payment that is
13 \$5,000/year greater in years 1 through 5.

- 14 2. Variable Abatements: Variable tax abatements are more complex to quantify, but are
15 essentially calculated in the same manner. Assume that Project B has been awarded
16 15-year tax abatement. In years 1 through 5, the abatement is \$25,000; in years 6
17 through 10 the abatement is \$10,000; and in years 11 through 15 the abated amount is
18 \$5,000. The interest rate on the insured loan is quoted at 7.5% and the MIP is .5%.
19 The amount of additional mortgage is calculated as the amount that could be fully
20 amortized by the variable payments over the 15-year period based on the stated
21 financing terms. The graph below illustrates the calculation.

\$25,000	(\$5,000)		Abatement Period 1 \$25,000 - \$10,000 = \$15,000 \$15,000 / 0.245455 = \$61,111
\$20,000	(\$5,000)		
\$15,000	(\$5,000)		
\$10,000	(\$5,000)	(\$5,000)	Abatement Period 2 \$10,000 - \$5,000 = \$5,000 \$5,000 / 0.147422 = \$33,912
\$5,000	(\$5,000)	(\$5,000)	(\$5,000) Abatement Period 3 \$5,000 - \$0 = \$5,000 \$5,000 / 0.116241 = \$43,014

1

2 When there are two or more abatement amounts and periods, and the amounts decline, the
3 abatement amount for each period is found by subtracting the abatement amount of the next
4 period. Period 1 will run for 5 years, Period 2 will run for 10 years, and Period 3 will run for
5 15 years. Because all three periods begin amortization at the same point in year 0, the
6 amount of the abatement for the next period must be subtracted to avoid double counting.

7

8 (1) Abatement Period 1

9 \$25,000 minus \$10,000 (the amount of abatement in period 2) = \$15,000 for 5
10 years. The debt service rate for a 5 year term at 7.5% interest with 5% MIP is
11 0.245455383. Dividing \$15,000 by 0.245455383 indicates additional mortgage
12 proceeds of \$61,111 attributable to period 1.

13 (2) Abatement Period 2

14 \$10,000 minus \$5,000 (the amount of abatement in period 3) = \$5,000 for 10 years.
15 The debt service rate for a 10 year term at 7.5% interest with 0.5% MIP is
16 0.147442123. Dividing \$5,000 by 0.147442123 indicates additional mortgage
17 proceeds of \$33,912 attributable to period 2.

- 1 (3) Abatement Period 3
2 \$5,000 minus \$0 (since there are no periods remaining) = \$5,000 for 15 years. The
3 debt service rate for a 15 year term at 7.5% interest with 0.5% MIP is 0.116241483.
4 Dividing \$5,000 by 0.116241483 indicates additional mortgage proceeds of
5 \$43,014 attributable to period 3.
- 6 (4) Adding the supportable mortgages from each of the abatement periods results in a
7 total additional supportable mortgage of:
- 8 Period 1 = \$ 61,111
9 Period 2 = \$ 33,912
10 Period 3 = \$ 43,014
11 Total = \$138,037

12
13 The mortgage amount based on debt service, (Criteria 5 of HUD 92264-A) would be
14 increased by \$138,037 and a special amortization schedule would be required with a debt
15 service payment that reflects \$25,000 per year in years 1 through 5, \$10,000 per year in
16 years 6 through 10, and \$5,000 per year in years 11 through 15.

17

7.17 Project Based Section 8 and LIHTC Processing

A. For Section 223(f). The project must be evaluated under two scenarios: a) the “hypothetical market value” of the project without regard to any Section 8 project based subsidies, rent restrictions or LIHTC, and b) a debt service analysis that considers all Section 8 project based subsidies and other low income rent restrictions must be performed. Two independent Section C rent schedules must be prepared, one for a hypothetical market rent estimate and one that recognizes all rent restrictions and subsidies.

1. Criteria 3 Market Value: The appraiser must ignore the Section 8 contract rents, tax exempt bond or LIHTC restricted rents when determining market value and the income to be capitalized for a determination of market value for the purposes of determining Section K, Form HUD-92264, and Criteria 3 Form HUD-92264-A Value. To be consistent, the appraiser must use a market capitalization rate and must assume market rents in the income approach to value. Note that the comparable sales approach to value must be completed without regard to Section 8 or LIHTC awards.

2. Criteria 5 Debt Service Analysis: In calculating net operating income to be used for Criteria 5 Debt Service, rent restrictions must be observed. For the Criteria 5 debt service analysis, the Line 6, Form HUD-92264-T rents must be used. This applies to projects receiving LIHTCs that may use either tax exempt bond or market-rate financing.

3. Form HUD-92264T for LIHTC projects without Section 8: Follow existing form instructions. Processing will be based upon the lesser of Lines 1, 4 or 5.

4. Form HUD-92264T for Section 8 Project Based Assistance without LIHTC:

a. Enter the market rent by comparison on Line 1

b. Enter Personal Benefit Expenses on Line 2

- 1 c. Line 3 is Not Applicable
- 2 d. Line 4 is Not Applicable
- 3 e. Enter the Project Based Section 8 Contract Rent on Line 5
- 4 f. Subtract Line 2 from Line 5 (if applicable)
- 5 g. Process using the lesser of Line 1 or Line 5

6

7 5. Form HUD-92264T for Section 8 Project Based Assistance with LIHTC:

8

9 The LIHTC rent must be recorded but is not used as a limiting criterion because

10 the total income to the project is the LIHTC rent combined with the Section 8

11 rent, so that the actual amount of rental income to the project will be the Project

12 Based Section 8 rent, as follows.

13

14	2 Bedroom Section 8 Contract Rent	\$850/Month
15	2 Bedroom LIHTC Rent limit	\$350/Month
17	Resident's Rent Obligation to Project:	\$350/Month
18	Section 8 Payment to Project:	\$500/Month
19	Total Income to Project	\$850/Month

20

- 21 B. Fee Income. If additional fees for project amenities are mandatory for all residents, the
- 22 mandatory fee income from restricted units must be excluded from the calculation of net
- 23 income. The mandatory fee income from non-restricted units may be included if these
- 24 amenity fees are indicated by comparable properties in the market and it must be
- 25 explained in the remarks section of Form HUD-92264.

- 26
- 27 C. Expenses/Fees: Properties with LIHTC restricted units will commonly have a higher
- 28 operating expense ratio per unit than market rate properties, which may be due to
- 29 increased administrative costs for tax credit compliance monitoring, performing resident
- 30 income certifications and staffing to provide on-site resident services. Estimating
- 31 operating expenses for projects that are to be funded through the sale of LIHTC, requires
- 32 the analysis of LIHTC comparables if available, and consultation with other experts (i.e.
- 33 appraisers and project managers) in the context of current market conditions which

1 should consider the size of the project and unit mix. Utility expense unit rent adjustments
2 in LIHTC projects may be estimated by the analysis of actual costs supplied by the
3 developer, the utility company or by use of the Section 8 utility allowances.

- 4 1. If the project has the same operating expenses under LIHTC or Project Based
5 Section 8 operation as it would under market rate operation, enter expenses as
6 usual.
- 7 2. If a project has different expense needs as a subsidized project, the expenses used
8 for Criteria 3 must be market rate expenses and the expenses used for Criteria 5
9 debt service shall be the actual expenses under its' proposed usage. This will insure
10 that the Criteria 5 - debt service analysis of the HUD 92264a is calculated based on
11 the actual estimate of the rent restricted NOI for the project.
- 12 3. Audit Fee no Longer Recognized. With the elimination of the requirement for an
13 audited cost certification for mortgage insurance transactions with LIHTC,
14 assuming the ratio of loan proceeds to the actual cost of the project is less than 80
15 percent, the audit fee will no longer be recognized as an allowable cost in the Total
16 Estimated Replacement Cost of Project, Section G line 66 Form HUD-92264.

17
18 C. Sections 220 and 221(d) Site Value and "As Is" Value:

19 The site value of land in new construction or the "As Is" value in substantial
20 rehabilitation cases is to be estimated using a capitalization rate and project NOI as if the
21 units and the project were unrestricted and market rate, without considering: a) any
22 additional value that may be attributable to subsidies available to the project or any
23 LIHTCs or other tax benefits the project will receive, or b) any value reduction due to
24 any NOI or value limitations caused by regulatory agreements or affordability restrictions
25 imposed by any subsidy program or tax regulation. This valuation methodology permits
26 sponsors to acquire project at its market value for new construction or rehabilitation of
27 affordable housing. The value attributable to the presence of LIHTCs diminishes over
28 time and is not always freely transferable, and thus should not be taken into
29 consideration.

30 **NOTE:** Cost Certification instructions (enforced by Statute) dictate that the **lesser** of
31 the "as is" value of the land and improvements (before repair or rehabilitation).**or** the
32 purchase price of the land and improvements, is used in the cost build up for criterion
33 3 of form HUD 92264A, in substantial rehabilitation cases. Consequently when
34 mortgage proceeds will be used to fund the acquisition of the project, the "as is" value
35 estimation will be used as a test of the reasonableness of the acquisition price.

1 When the acquisition price is less than the “as is” value of the land and improvements
2 (as accepted by HUD), and mortgage proceeds will be used to fund the acquisition of
3 the project, the acquisition price will be used in the cost build up for criterion 3
4 forming the cost basis for the firm commitment

5 When the acquisition price exceeds the “as is” value of the land and improvements
6 (as accepted by HUD), then the acquisition price must be reduced to the “as is” value
7 and will, subsequently, comprise the basis of the cost build up for the firm
8 commitment.

9 When mortgage proceeds will **not** be used to fund the acquisition of the project, the
10 “as is” market value of the project will be used in the cost build up for criterion 3
11 forming the cost basis for the firm commitment. This is particularly significant when
12 below market rent restrictions, (such as in the case of LIHTC limited rents or Section
13 8 rent subsidy) are in place and the use of market rents in valuing the project will
14 result in a premium over these rent restrictions. (See Section 7.10 A 9, defining how
15 market rents are derived as the basis for the “as is” value)

16 D. Income Limits. The HRA must ascertain that the correct income limits are employed in
17 calculating the maximum LIHTC rents and in completing Form HUD-92264-T. HERA
18 modified HUD’s income limit methodology for calendar years after 2008 to require HUD
19 to increase applicable area median incomes by the amount area median incomes rise,
20 even if the HUD- determined area median incomes would be frozen under HUD’s 2007
21 and 2008 income limit methodology.

22
23
24

7.18 Appraisal Review Policy and Requirements

A. Scope of Work.

1. Scope of Work includes project identification, extent of inspection, the type and extent of data researched and the kind of analysis needed to arrive at opinions or conclusions. The rule also states that appraisers have broad flexibility and significant responsibility in determining the appropriate scope of work for an appraisal or appraisal review assignment.
2. According to USPAP, appraisers, including HRAs are responsible for determining the scope of work. However as an employer who is also the client, the Department may issue guidance as to what is the extent of an assignment for a review appraisal. It is not a violation of USPAP for an appraiser to accept an assignment, in which a limited scope of work is appropriate, so long as the assignment and scope of work are clearly defined, produces credible results and is performed objectively without bias.
3. HRAs may have to expand the scope of work and do additional research in performing an assignment. The HRA should discuss such situations with management in order to determine whether additional work by HUD staff is appropriate, or if the application should be rejected or approved with conditions.
4. According to USPAP, if relevant information is not available because of assignment conditions that limit research opportunities (such as conditions that place limitations on inspection or information gathering), an appraiser must withdraw from the assignment unless the appraiser can still develop credible assignment results. For example, they may be able to modify the assignment conditions to expand the scope of work to include gathering the information, or use an extraordinary assumption.

B. Jurisdictional Exception Rule.

- 1 1. The Jurisdictional Exception Rule provides a saving or severability clause
2 intended to preserve the balance of USPAP if compliance with one or more of its
3 parts is precluded by the law or regulation of a jurisdiction. When an appraiser
4 properly follows this Rule in disregarding a part of USPAP, there is no violation
5 of USPAP.

 - 6 2. USPAP defines law as including constitutions, legislative and court-made law,
7 administrative rules and ordinances. Regulations include rules or orders having
8 legal force, issued by an administrative agency, such as HUD. This would include
9 Handbooks, Notices, and the MAP Guide. Instructions from an attorney or a
10 client do not establish a jurisdictional exception

 - 11 3. The need to take a Jurisdictional Exception should be rare. If it is needed, the
12 appraiser or HRA must specifically cite the regulation and the portion of USPAP
13 that is affected. Verbal direction from management is not sufficient to justify an
14 exception. The HRA must cite a citation from the MAP Guide or other
15 appropriate authority.
- 16 C. Record Keeping Rule. This rule specifies record keeping procedures for appraisers. The
17 rule does not mandate that an appraiser have possession of assignment work-files. The
18 Department does not permit permanent or personal possession of records relating to a
19 review appraiser's work. The Department retains these records for far more than the time
20 required under USPAP and will, with due process of law, cooperate with appraiser
21 regulatory agencies, professional peer review committees, and to assist obtaining a
22 professional designation. Appraiser work-files will be maintained in the Satellite office.
23 When an HRA leaves employment they shall be transferred to the Regional Office.
- 24 D. Loan Committee. HRAs are expected to complete workload assignments to facilitate
25 loan approval (or rejection) including an executive summary and other material needed
26 for Hub or National Loan Committees. The summary is intended to allow peers and
27 management the ability to efficiently complete their reviews and conclusions. The
28 Department allows the use of an alternative format for the NLC narrative as long as it is
29 approved by the Regional Center Director and contains an executive summary. It is the

1 Department's position that its program and instructions are in compliance with USPAP.
2 Management has the right to disagree with conclusions made by HRAs or any other
3 technicians. Management should document the file with the reasons for any
4 disagreement. The original conclusions are part of the permanent project file.

5 E. Workload Sharing. Workload Sharing arrangements may require HRAs to perform
6 reviews without the benefit of being able to do a physical inspection. The assignment will
7 generally be completed with the HRA making certain assumptions, such as the condition
8 to be consistent with the photographs and other reports.

9 F. Consultations with other staff. HRAs may be required to provide consultation with
10 senior underwriters and other staff who have been asked to review an appraisal. A
11 Frequently Asked Questions grid included in Addendum 7 that discusses tasks which can
12 be accomplished, as well as the level of required USPAP compliance

13 G. Environmental Processing. The responsibility for environmental processing has been
14 typically assigned to the HRA, though other appropriately trained HUD staff may also
15 perform these reviews. Federal regulations (24 CFR Parts 50.11 and 50.32) require that a
16 HUD approving official make an independent evaluation of the environmental issues,
17 take responsibility for the scope and content of the compliance finding, EA or EIS, and
18 make the environmental finding. This function cannot be delegated to a lender or the
19 lender's or owner's consultants. The HRA staff appraiser or other environmental
20 reviewer can and should be provided with information from the lender or the lender's
21 consultant, however, the function must be performed by HUD staff.

22 When HUD staff appraisers are assigned this duty, it is not considered an appraisal
23 assignment subject to USPAP requirements. The Department expects the appraiser or
24 other responsible staff to ensure compliance with Wetlands/Flood Plain Executive
25 Orders, Fish and Wildlife, Historic Preservation, etc., and to obtain such information as
26 needed from other governmental or private sources, based on review of the lender
27 prepared Phase I Report and preparation of any required documentation.

28 H. Technical Appraisal Review Requirements. The HRA or senior underwriter must follow
29 the review requirements listed below:

- 1 1. Exhibits. The lender must submit the exhibits listed in Section 7.10.A to HUD.
- 2 2. Market Study Review. The HRA or senior underwriter and the EMAD economist
3 must each provide a desk review of the market study to determine reasonableness
4 and compliance with Chapter 7.5 the HRA must make final recommendations to
5 the team leader regarding market demand for the project.
- 6 3. Level of Inspection. The HRA or senior underwriter must state the level of
7 inspection. Preferably they should must inspect the subject site and as many as
8 possible of the comparables used in the appraiser’s HUD-92273 and HUD-92274
9 analyses.
- 10 4. Environmental Review. The HRA (or other designated employees) must review
11 the Phase I ESA, and prepare any required documentation.
- 12 5. The HRA must review site characteristics and make a recommendation regarding
13 site acceptability to the team leader.
- 14 6. The HRA must determine that the comparables submitted are acceptable.
- 15 7. From a review of Forms HUD-92264, HUD-92273, HUD-92274, and supporting
16 information, the HRA must make a recommendation to the team leader regarding:
 - 17 a. The acceptability of the proposed rents and estimated rental income.
 - 18 b. The acceptability of the total operating expenses.
 - 19 c. The acceptability of the site and the estimated warranted price of land or
20 “as is” value.
 - 21 d. If applicable, the estimate of market value.
 - 22 e. Any recommended modifications necessary to approve the application
23 instead of a categorical rejection. Any value conclusions made by HRA
24 that differ from the appraisal under review require preparation of a work
25 file in accordance with Standard 1 of USPAP. Only licensed appraisers
26 may develop a different value. The Department prefers that the HRA or
27 senior underwriter only opine on the quality of the work under review and
28 as to whether or not it is reliable for use in underwriting mortgage
29 insurance.

- 1 8. Compliance with USPAP. The HRA or senior underwriter must also ascertain if
2 the appraisal complies with Standard 3 of the Current USPAP. Senior
3 underwriters must make themselves familiar with USPAP or consult as necessary
4 with the HRA.
- 5 I. Documentation of the Appraisal Review. The Department’s SharePoint site contains a
6 number of appraisal review templates as well as review forms from the previous MAP
7 Guide. HRAs and senior underwriters have a great deal of flexibility in the format that
8 they use, so long as it is approved by the Regional Center Director and contains an
9 executive summary.

DRAFT

Chapter 8 Mortgage Credit

Section 8.1 Introduction

Principals and entities participating in FHA multifamily mortgage insurance programs must have a good credit history, demonstrating that they will honor their legal, financial and contractual obligations. All principals must be identified and analyzed with respect to credit, experience, and financial histories. Regulatory standards are established in the Code of Federal Regulations (CFR) to determine the appropriate review of participants in multifamily insured programs based upon their past performance as well as other aspects of their records. This chapter explains FHA's underwriting criteria for determining creditworthiness of principals.

In many areas addressed in this chapter, separate policy has been developed for Low Income Housing Tax Credit projects, and this policy is presented in Chapter 14. If conflicts arise in areas addressed by both this Chapter and Chapter 14, Chapter 14 guidance should prevail in the underwriting of Tax Credit Projects. Likely conflicts will be in Part 8.7, *Secondary Financing*, Part 8.8, *Application Exhibits*, particularly with respect to Tax Credit Pilot projects, and Part 8.15, *Bond Financed Projects*.

Section 8.2 Borrower Types – Single Asset Borrower Entity

A single asset mortgagor entity is required for all multifamily FHA mortgage insurance projects. Natural Persons, Delaware Statutory Trusts and Tenants in Common are not eligible, although such entities can have ownership interests in the single asset entity mortgagor. Acceptable forms of single asset entities that may participate in FHA insured transactions include the following:

1. General Partnership (GP) with one or more general partners.
2. Limited Partnership (LP) with one or more general partners and one or more limited partners.
3. Corporation, C Corporation, or S Corporation with shareholder owners and corporate

- 1 officers and directors who may or may not be shareholders.
- 2 4. Limited Liability Company (LLC) composed of members, with one or more
3 managing members and one or more investor members.
- 4 5. Trust (when borrower is a trust the duration of the trust must be equal to or longer
5 than the term on the FHA Note) with beneficiaries and one or more trustees.
- 6 6. Nonprofit corporation with officers and directors.
- 7 7. Any other public or private single asset borrower entity.
- 8 8. Generally, foreign nationals and corporate entities may participate as principals.
9 However, the single asset borrower entity must be registered in the United States and
10 in the State where its corporate office is located, in the event a law suit is filed. At
11 least one principal with operational decision-making authority must be a United
12 States citizen or a foreign national lawfully residing in the United States, having an
13 immigration status granted by the United States government that would enable that
14 person to exercise such authority.
- 15 9. EB5 is a visa program that offers foreign nationals a visa and path to citizenship in
16 exchange for investing at least \$500,000 in a job creating business in the US. It
17 provides low cost equity (since the main benefit to the user is the citizenship rather
18 than financial returns). Typically, the EB5 investors would form an LLC that would
19 provide the bulk of the equity investment. Depending on the number of jobs
20 supported by the project, the loan to cost ratio might be well below FHA limits.
- 21
22 Each EB5 investor would 1) hold a financial interest of much less than the 25%
23 maximum interest allowed, and 2) have no day-to-day management authority. We
24 expect that there would be a US based developer and managing member of the
25 project's ownership entity, which would meet HUD requirements for a domestic
26 principal/manager.
- 27 10. Any combination of acceptable ownership forms can be used to establish a joint
28 venture for the purpose of jointly sharing the risks and the rewards by contributing the
29 appropriate knowledge, skills or assets necessary to a successful development project.
30 However, a single asset entity is always required.

31 **Section 8.3 Who Is a Principal**

32

1 A principal is an individual or business entity that maintains significant decision-making
2 authority regarding an FHA multifamily loan transaction, or retains a percentage of ownership in
3 a single asset borrower entity. The term principal is used in several ways:

- 4
- 5 (1) persons or entities which must be disclosed for Form 2530 Previous Participation
6 review;
- 7 (2) persons or entities required to execute Section 50 of the HUD Regulatory Agreement;
8 and
- 9 (3) persons or entities which possess financial and/or legal control of the borrower,
10 thereby requiring full or limited financial and credit analyses.
- 11

12 Unless the context specifically refers to applicability of previous participation review or
13 identifying signators for section 50 of the HUD regulatory agreement, “principal” in this chapter
14 refers to those people or entities that, if they had significant financial or legal problems, could
15 undermine the effective ownership oversight of the property and therefore require financial and
16 credit review.

17

18 A principal is a public or private entity proposing to participate in a project as a sponsor, owner
19 or prime contractor. The principal’s role can involve active participation in directing the
20 activities and affairs of the borrower entity and involvement in decision-making, or passive
21 (inactive) participation when an ownership interest has been acquired. A minimum level of
22 disclosure and underwriting is required for all principals whether their role and relationship to
23 the property is active or passive. A significantly greater level of disclosure and underwriting
24 scrutiny is required for principals.

- 25
- 26 1. Principals are those who, singly or with others, direct and control the borrower and are
27 responsible for the borrower’s ability to execute any and all actions required for the
28 benefit of the property. More specifically, a primary principal maintains a substantial
29 financial interest in or has active operational control over the borrowing entity.
30 Accordingly this principal possesses financial and managerial capabilities, has strong
31 creditworthiness essential for successful operation of the property being financed, and
32 exercises decision making control over the property. Typically, this principal has
33 substantial ownership interest in the borrowing entity. All investors with 25% or more
34 ownership are considered to be participants.

35 Principals must have positive experience and qualifications in developing, owning or

1 building multifamily properties reasonably comparable in kind and scale to the subject of
2 the proposed transaction. Comparable in kind and scale means: (a) similar in physical
3 size (e.g. number of units) and building type and uses (e.g., low rise, high rise,
4 commercial spaces); (b) similar financially (e.g. revenues, expenses, size of mortgage,
5 required liquidity); (c) similar operationally (e.g. target markets/tenant population,
6 elderly, subsidized or affordable) and (d) similar in kind of transaction purpose (e.g.
7 acquisition, re-positioning/turn-around, rehabilitation, new construction).

8 Principals do not include:

- 9 1. Limited liability corporate investors (i.e. syndicators and direct investors) and passive
10 investors in FHA mortgaged insured property.
- 11 2. Parties whose sole interest is that of purchaser or owner of less than five individual
12 unit(s) in the same condominium or cooperative development; (ii) parties whose sole
13 interest is that of a tenant in not more than two units in an FHA mortgaged insured
14 property.
- 15 3. Public Housing Agencies (PHAs) where the PHA is acting in its capacity as a PHA
16 owning and/or operating public housing. However, PHAs are expected to form single
17 asset entities to hold properties financed with FHA mortgage insurance.
- 18
- 19 2. Passive principals are typically those who have limited or no decision making power or
20 control over the ownership entity. A passive principal's financial or other obligations to
21 the borrower and the property may be fixed and defined before endorsement, with the
22 borrower or its principals having limited or no power to compel a passive principal to
23 increase its obligations. A passive principal may have limited power singly or with
24 others, or no power to remove, replace or diminish the powers, or alter the compensation
25 of principals. As used here "limited" means that the rights of a passive principal to exert
26 control or effect decisions that are defined in organizational documents and are limited to
27 specific actions intended to remedy negligence or default by a principal, or to protect the
28 passive principal from loss due to a default or failure of performance by the borrower.
29 Some participants may be principals by reason of a professional role or service provided
30 to the borrower and some or all compensation may be provided by means of an
31 ownership interest in the borrower. These professionals may merit alternate
32 consideration as noted below.
- 33

1 3. Passive investors with an ownership interest of less than 25% (10% if a corporation) who
2 maintain an active, day to day decision making role, are subject to prior credit approval if the
3 investor has greater than \$250,000,000 of outstanding FHA-insured debt. (See Chapter 8.8.)

4
5 *A. Regulatory and Processing Requirements for Previous Participation*
6 *Certification*

7
8 For any multifamily project financed or proposed to be financed with an FHA insured mortgage
9 under the National Housing Act, an individual or entity serving in any of the following capacities
10 as a principal is also considered to be a participant:

- 11 1. A borrower and/or any affiliates of a borrower;
- 12 2. An owner, if different than borrower, e.g. in a transfer of physical assets (TPA);
- 13 3. A management agent; and/or
- 14 4. A general contractor.

15 In addition to the entities named above, a person or entity determined by HUD to have control
16 over the financial or operational decisions of an FHA- insured property shall also be considered a
17 participant.

18
19 The previous participation certification procedure assesses the experience of applicants with
20 FHA-HUD insured mortgage programs and with the United States Department of Agriculture
21 Rural Development (USDA-RD) multifamily programs. All principals must submit an electronic
22 Previous Participation Certification via the Active Partners Performance System (APPS), or a
23 paper Form HUD-2530 pursuant to 24 CFR 200.217 and 200.218. They are responsible for its
24 timely filing with the local HUD office with jurisdiction over the project application or proposal.
25 Form HUD-2530 is not a substitute for processing the application for project acceptability, credit
26 capacity, or competency. Paper submissions are acceptable if the participants are having trouble
27 with the APPS access. All principals must certify and sign the certificate personally as to their
28 individual record and are responsible for its timely filing with the Regional Center having
29 jurisdiction over the project. Any participant experiencing trouble with, or to learn more about
30 APPS, get registered, access the user guide and use the tutorial should visit HUD's website at
31 <http://www.hud.gov/offices/hsg/mfh/apps/appsmfhm.cfm>. Submissions are required from the
32 following:

- 1
- 2 1) Tax credit syndicators with an identity of interest in the general partner.
- 3 2) For-profit entities and each member of the entity's board of directors (BOD) must
- 4 individually certify and sign the certificate.
- 5 3) Nonprofit borrowing entities and each member of its board of directors serving in the
- 6 role of an officer.
- 7 4) A previous participation certification (through either a form 2530 or APPS) is not
- 8 required in the following situations or roles:
 - 9 a) When a corporation (for-profit or nonprofit) is a principal, all its officers,
 - 10 directors and principal stockholders need not individually sign, certify nor file the
 - 11 certificate when they all have the same record. When their previous participation
 - 12 records are identical the officer authorized to sign for the corporation will list on
 - 13 the certificate the full names for all such principals connected with the corporation
 - 14 who do not elect to sign. Those principals who have a separate participation
 - 15 record outside that of their corporation must certify, sign and file. The objective
 - 16 is full disclosure.
 - 17 b) Attorneys and architects with only an arms-length fee arrangement for services;
 - 18 c) Sub-contractors;
 - 19 d) Minor corporate officers;
 - 20 e) Officers and directors of corporations which are passive principals (e.g. pass-
 - 21 through/ shell company);
 - 22 f) Parties whose sole interest is that of purchaser or owner of less than five
 - 23 individual unit(s) in the same condominium or cooperative development; and
 - 24 parties whose sole interest is that of a resident;
 - 25 g) Passive Tax credit investor partners are exempt in accordance with Section 2(2)
 - 26 of the Preservation Approval Process Improvement Act of 2007. (This document
 - 27 does not pertain to Historic or New Market Tax Credits, described in Chapter 14
 - 28 Tax Credit). However they are required to submit the *Identification and*
 - 29 *Certification of Eligible Limited Liability Investor Entities*;
 - 30 h) Tax credit syndicators, investor members of LLCs, investor partners of limited
 - 31 partnerships or any other passive partners, even in the case of an identity-of-
 - 32 interest. However they are required to submit the *Identification and Certification*
 - 33 *of Eligible Limited Liability Investor Entities*;
 - 34 i) Public Housing Agencies/Authorities, who are subject to separate treatment for
 - 35 projects redeveloped under the RAD program; and

1 j) Brokers whose services are limited to referring the loan to a lender and
2 presenting information on behalf of the borrower.
3

4 *C. Nonprofit Principals*

5
6 Nonprofit principal is understood to mean “the borrowing entity and its Board of Directors”
7 (BODs). The BODs are treated as persons acting in the role of an officer and/or a
8 member/director.
9

10 1. Nonprofit entities and sponsoring parent organizations that are principals must
11 demonstrate financial strength, credit history, experience and capacity. Executive
12 officers must provide resumes evidencing experience commensurate with the
13 requirements of the project, as well as the certification provided on the HUD Form 2013-
14 SUPP as to past or on-going litigation, judgments, bankruptcy and delinquent federal
15 debt. Generally, analysis of personal financial statements including verifications of
16 deposit or available liquidity is not required of officers of nonprofits. Any member of a
17 nonprofit Board of Directors who acts in an executive capacity must be treated as an
18 executive officer.
19

20 2. Where a nonprofit is not a principal but proposes a role such as property manager,
21 service provider, or an intermediary with a local community or constituency, the
22 nonprofit must demonstrate experience, management ability and financial capacity to
23 execute the proposed services.
24

25 *D Definition of Principal for Regulatory Agreement Provision Section 50*

26 1. For privately held entities: The provision generally requires two signatures for project
27 sponsors. In most cases, HUD, upon the lender’s recommendation, shall select an
28 individual signatory to sign in his or her individual capacity and the project
29 parent/sponsor entity to sign in a corporate capacity. In any specific deal, underwriting
30 may conclude that an entity with the requisite control and involvement or interest in the
31 Project which possesses a positive credit history and adequate financial strength relative
32 to the size of the loan may serve in the capacity required by Section 50. In some
33 circumstances, particularly involving large, capitalized, and experienced corporate
34 entities with complex corporate organizational structures, the underwriting may not
35 reveal any apparent individual to reasonably serve in the required capacity, whereas the
36 parent/sponsor entity itself may possess such necessary characteristics to act as the sole
37 necessary signatory. In considering whether or not such an entity may serve as the sole

1 signatory to Section 50, HUD and the lender shall consider whether the entity has been
2 approved as an appropriate signatory to provisions similar to Section 50 in a recent GSE
3 transaction. Provided that such an entity is determined to hold the requisite positive
4 credit history and adequate financial strength required by Section 50, the GSE-approved
5 entity may be an appropriate sole signatory for Section 50. A copy of relevant excerpts
6 from the recently-closed transactions would evidence such GSE approval.

7 2. For publicly traded corporations or REITS, or nonprofit organizations: The
8 parent/sponsor entity itself is acceptable as the sole signatory. For such entities, any
9 individual signing on behalf of the corporate entity does not sign in an individual
10 capacity, but to bind the parent/sponsor. No personal liability will be claimed against the
11 individuals signing in such a capacity.

12 3. For nonprofit borrowers, the parent/sponsor entity should be named. Only in limited
13 circumstances on a fact-specific, case-by-case basis, such as when there is no
14 parent/sponsor entity of a nonprofit, would the borrower entity be named in Section 50.
15 In almost all cases, except in such extraordinary circumstances, the borrower should not
16 be named in Section 50.

17 4. For any corporate entities required to execute Section 50: Every corporate officer is
18 not required to sign. Whomever the corporate entity has authorized to bind the company
19 in connection with the proposed transaction may sign, provided that Mortgage Credit
20 review has

21 discretion to require additional signatories if warranted in a specific (exception)
22 situation.

23 5. The following prohibitions relate to Section 50:

- 24 i. Insertions of “or successors” language to the identification of signatories is
25 not allowed. The Regulatory Agreement can and should be amended when
26 there is a new individual who is responsible for the provisions of Section 50.
27 ii. Riders to the regulatory agreement that attempt to limit a signatory’s liability
28 are not allowed.
29 iii. Section 50 may not be omitted simply because a project has been processed
30 as a Section 223(a)(7).

31 6. It is the lender’s responsibility to perform the mortgage credit review of the
32 parent/sponsor entity and to identify and verify the identity of the signatory of Section 50
33 of the Regulatory Agreement. The signatory will be identified in a special condition to
34 the firm commitment (or in a letter Amendment to the Firm Commitment).

Section 8.4 Investigating Credit and Character

A. It is the responsibility of the MAP Lender's underwriter to review the mortgage credit exhibits, identify credit issues and/or resolve discrepancies in order to determine that the borrower and the principals have demonstrated: (a) both the willingness and the ability to pay creditors in accordance with agreed terms; (b) the ability to deliver timely and satisfactory performance of contractual or business obligations, and (c) the mitigation of litigation risks by honoring prior loan obligations (especially during adverse market/financial conditions). The underwriter must verify the passive principals' role in the organization and identify and explain any existing financial or other obligations of the borrower. If a passive principal has a decision making obligation to the borrower, the underwriter must include a credit investigation on that principal.

1. Use of credit reports. Credit reports or credit histories are a means of validating and cross checking information received from the borrower and principals in financial statements and in application exhibits. Credit reports give a picture of payment history and financial interactions with creditors. The lender must reconcile any contradictions with a summary statement.

2. A commercial credit report for a business or a residential mortgage credit report (RMCR) for individuals must be current within 60 days of the application acceptance date and HUD may require updated reports during processing. Merged credit reports from the three major credit bureaus are acceptable, but compiled infill reports are not acceptable.

3. For principals who are individuals, credit reports are needed for the individual and for that individual's other business concerns (i.e. ownership of property management firm, general contracting or subcontracting firm, or land or property development entities). Pending judgment(s), legal actions or suits or bankruptcy claims should be included in the report. The lender should randomly select 10% or more of the principal's other business ventures or property operating companies for credit review.

4. For general contractors, credit reports are required for the business entity and its operating affiliates, if any. Reports should be submitted for the principal(s) of the general

1 contractor unless the financial capacity and track record of the general contractor entity is
2 deemed sufficient to assess credit risk.

3
4 B. Lender's Review of the Credit Report. The lender is required to do all of the following:

5 1. Compare all information obtained from credit reports and histories to the financial
6 statements provided by the relevant borrower or principal(s). Resolve or explain
7 contradictory information.

8
9 2. Make reasonable inquiries to determine if the applicant or any principal is in default on any
10 type of federal debt including direct loans, HUD insured loans, student loans, Small Business
11 Administration loans or judgment liens against the property.

12
13 3. Investigate any adverse credit information that appears on the credit report or becomes
14 known from inquiries received from other HUD offices, and obtain a written explanation
15 of any late payments, actions, judgments or derogatory information.

16
17 B. Delinquent Federal Debt, Judgments and Pending Litigation

18
19 1. When delinquent federal debt is identified, the lender must include as part of the
20 required application exhibits:

21
22 a. A detailed written explanation from any applicant or principal with a prior
23 federal default or claim or whose credit report and financial statements contain
24 conflicting or adverse information;

25 b. A letter from the affected agency, on agency letterhead and signed by an
26 officer, stating the delinquent federal debt is current or satisfactory arrangements
27 for repayments have been made; and

28 c. The lender's reason(s) for recommendation of the applicant, which may be
29 included in the lender underwriter's review and recommendation.

30
31 2. The lender shall also investigate any other serious adverse information, including but
32 not limited to bankruptcies, defaults on real estate mortgages, tax liens, foreclosures or
33 deeds-in-lieu of foreclosures, and judgments and pending litigation.

34
35 B. Trade and Credit References

- 1
- 2 1. HUD requires a completed Fannie Mae Form 1006, *Request for Verification of*
- 3 *Deposit* or bank statements to verify borrower assets for each bank reference listed in the
- 4 credit report. Deposits and/or marketable securities of the principal must be verified and
- 5 examined in light of the principal's liquid assets reported on financial statements. Both
- 6 sources should be reasonably consistent, and any significant differences should be
- 7 explained. When principals' financial statements show real estate owned and other
- 8 mortgage debt, bank references must include a sampling of mortgage payment histories
- 9 and must confirm the character, business acumen, expertise and timeliness of the
- 10 principal in meeting their business obligations.
- 11 2. Written inquiries of trade references should include a copy of the certification
- 12 authorizing the release of credit information.
- 13

14 C. Rejection Because of Unacceptable Character and Credit

15

- 16 1. The lender's professional judgment is required in approving or rejecting principals on
- 17 the basis of character and credit.
- 18
- 19 2. The principal should be a credit rejection if:
- 20
- 21 a. The principal has a history of late payment or non-payment of creditors, or has
- 22 defaulted on debt without making reasonable attempts to remedy or cure the
- 23 default. The underwriter may not recommend approval of a principal with a
- 24 history of default without contacting the defaulted lender to determine the
- 25 circumstances surrounding the default with a summary of these discussions
- 26 included in the lenders narrative.
- 27 b. Delinquent federal debt has not been resolved or satisfactory arrangements
- 28 made for repayment.
- 29 c. There are judgments or actions against the party, which:
- 30 (1) *Could significantly impact the financial position of the individual/*
- 31 *firm or corporation, or*
- 32 (2) *Result in a determination that the individual/firm or corporation is an*
- 33 *unacceptable credit risk.*

1 d. The principal is insolvent or is the subject of a pending bankruptcy or
2 insolvency proceeding at the time of application, issuance of the Firm
3 Commitment, or at the time of loan closing.
4

- 5 3. Principals with repaired credit may be considered for approval provided that a
6 positive credit history has been established and sustained for a period of time
7 encompassing both favorable and unfavorable economic conditions and that the
8 principal has during that time been engaged in financial transactions and/or business
9 enterprise comparable in scale to the proposed insured mortgage transaction. It is
10 unlikely that this period of time would be less than 7 years.

11 **Section 8.5 Evaluating Financial Capacity: Analysis of Financial** 12 **Statements**

13 The financial statements should be reviewed to determine if the sponsors, the borrower and/or
14 the principals of the borrower have the financial capacity to own and operate the property. For
15 construction proposals an analysis of financial statements is used to determine whether the owner
16 and the general contractor have the singular ability to deliver the project. These determinations
17 are based on:

- 18 a. Past financial condition,
19 b. Present liquidity, and
20 c. Projected future financial capacity.

21 **A. Submission of Financial Statements - General**

22 The sponsor, borrower (if fully capitalized) and/or its principals, and the general
23 contractor must submit with the loan application current financial statements to include a
24 balance sheet, income and expense statement, supporting schedules, a REO schedule and
25 the schedule of mortgage debt. Individuals will submit a Personal Financial and Credit
26 Statement, Form HUD-92417 and if applicable an REO schedule and schedule of
27 mortgage debt. See Appendix 8.A. for detailed requirements.

28 The financial analysis is used to determine the amounts available for investment in the
29 project by performing an analysis of working capital. Working capital is the difference
30 between current assets and current liabilities and is the cash or liquidity that exists to
31 purchase assets, pay off debt and make up deficits from operations or fund new activities or
32 projects. The financial analysis also determines which non-pledged assets can be readily

1 used as collateral or pledged as security to obtain cash. See Appendix 8B for instructions on
2 how to correctly analyze financial statements when determining the financial capability of the
3 borrower, Sponsor, General Contractor and/or Manager of an LLC.

4 B. Section 223(f) Project Financial Statements.

5 1. The borrower must submit:

- 6 (1) the last 3 fiscal years financial statements on the project and if more than 3
7 months have expired since the closing date of the most recent financial
8 statements, a year-to-date balance sheet and operating statement,
9 (2) copies of the most recent insurance and property tax bills, and
10 (3) 3 years of tax returns for the property or borrowing entity.

11 If the statements are not audited, a CPA or IPA “reviewed” statement is required.
12 “Audited,” and “Reviewed,” are defined professional standards for reports
13 understood by CPAs. The intent of the requirement is to obtain an independent
14 (non-identity of interest) professional review of the financial statements certified
15 by the Owner. If the statements are audited by an independent CPA or IPA, no
16 further review is needed to validate the statements.

- 17 2. For refinance applications, financial statements for the last complete fiscal year
18 must be CPA or IPA reviewed. Interim or year-to-date financial statements may
19 also require such review, or if the project has a history of stabilized occupancy
20 and financial performance, and borrower-certified interim statements may also be
21 acceptable. Examples of when interim financial statements might require CPA or
22 IPA review include factors such as: 1) period covered is all but the last month of
23 the fiscal year, 2) there is a soft market or case specific risk factors, and 3) the
24 project is applying under the three-year rule waiver and has just reached
25 sustaining occupancy. For this purpose “CPA reviewed” means a review by a
26 Certified Public Accountant and “IPA reviewed” means a review by an
27 Independent Public Accountant of the records and statements of the mortgagor
28 specifically including:

- 29 (1) The property’s financial statement(s) for the period;
30 (2) Rent rolls for each month of the period;
31 (3) Bank statements for not less than the last 6 months of the period;
32 (4) The mortgagor’s income tax return for the last fiscal year; and
33 (5) Reconciliations of rent rolls to financial statements and financial statements to
34 normalized operations, cash receipts and tax returns.

35

- 1 3. There may be circumstances beyond the borrower's control where the required
2 financial statements are not available because of loss by fire, arson, theft, flood
3 event etc.
4 (1) The borrower must submit:
5 (a) Evidence satisfactory to the lender that the financial statements are not
6 obtainable; and
7 (b) Project financial statements that are available including an owner-
8 certified balance sheet and operating statement. (See item c. below)
9 (c) In all cases, the borrower must submit the past 3 years of tax returns
10 for the property and the borrower entity.
11 (2) Lender's case file must contain a statement from the borrower that explains
12 why all the required records are not obtainable and a memorandum from the
13 underwriter to the Regional or Satellite Office Director stating that he/she
14 has evaluated the borrower's statement and agrees that the information is not
15 available.
16 4. Any owner-certified financial statement or owner-certified balance sheet and
17 operating statement must include certification and criminal warning found in
18 Appendix 8.
19 5. Past Due Payables and Past Due Project Liabilities. Past due accounts payable
20 and outstanding liabilities for project operating expenses must be cleared and
21 released, or otherwise fully resolved, before or at Initial Closing. Examples of
22 such items include deferred management fees, over-due utility bills or real estate
23 taxes, and trade payables. These items are not to be included in the eligible debt
24 basis in the calculation of the cost of refinance/ acquisition. If the transaction
25 does not involve a Transfer of Physical Assets (TPA), and if approved by the
26 Regional Center Director, surplus cash notes may be established for payables
27 owed to a related entity. Accounts payable and outstanding liabilities that are not
28 past due do not need to be resolved at or before closing.

29 C. Processing Financial Statements and Other Documents.

- 30 1. A current financial statement must be no more than 3 months old when Form HUD-
31 92013 is submitted to the lender for Firm Commitment review. The lender must
32 determine financial stability and financial strength, unless the borrower and sponsor is
33 a public company with an investment grade credit rating. Exceptions:
34 a. The credit investigation or other circumstances may warrant more current
35 financial statements.

- 1 (1) Assess the adequacy of each sponsor’s liquidity and its ability to provide
2 immediate and ongoing support to the property, as well as to any asset that is
3 in financial difficulty. For those properties in financial difficulty, consider
4 that property’s strength as well as liquidity sources outside the property, such
5 as the sponsor. The lender must look for likely future events that may drain
6 cash resources from the sponsor.
- 7 (2) The lender may include other sources of sponsor cash flow in the analysis, if
8 the source and stability of the cash flow has been verified by reviewing
9 historical tax returns. Do not include interest income from notes receivable,
10 real estate investment income, dividend income and sponsor salaries.
- 11 b. Audited or reviewed financial statements prepared by a CPA or IPA independent
12 public accountant may be up to 1 year old. The audited or reviewed statements
13 must be supplemented with updated interim financial statements and supporting
14 documentation, which may be management-prepared, if more than 6 months have
15 elapsed since the closing date of the audited statement.
- 16 2. A borrower entity with adequate capital must provide financial statements on the
17 individual ownership interest(s). This borrower entity must be fully funded in an
18 account in the name of the borrower entity.
- 19 3. A working capital determination is to be made for the borrower and the general
20 contractor from a review of the financial statements. The net working capital is to be
21 adjusted for the effect of contingent liabilities and the financial needs of other
22 projects in the planning stage or under construction, adjusted by the percentage of
23 completion.
- 24 4. Net worth in lieu of working capital occurs when existing assets can secure loans or
25 lines of credit to cover the project’s financial requirements and such loans or lines of
26 credit are confirmed as being available. In this case, the underwriter should
27 recommend approval based on “true net worth” rather than on working capital; and
28 a. Require the principal to provide a commitment letter from a lending institution
29 that states:
 - 30 (1) The rate, amount, term and conditions, if any, of the loan that the lending
31 institution is willing to provide.
 - 32 (2) The date by which the commitment letter must be exercised. The date must
33 extend at least to the anticipated date for initial endorsement.
 - 34 (3) The party that will be responsible for repayment of the loan or line of credit, if
35 the commitment is exercised.
 - 36 (a) Repayment may not be an obligation of the borrower entity.

- 1 (b) A certification indicating that the lending institution will not make any
2 claim against the mortgaged property, mortgage proceeds, any reserve or
3 deposit required by HUD, or against the rents or other income from the
4 mortgaged property for payment of the loan or line of credit. This
5 certification must contain the criminal certification found in Appendix 8A.
- 6 5. Funds provided by a parent company or affiliate of the sponsor require a certification
7 from the Board of Directors or authorized agent that specifies the funds the parent
8 company/affiliate will commit. Establish the availability of funds from the parent
9 company/affiliate. Consider whether:
 - 10 a. Individual corporations have any excess operating capital (e.g. restricted assets)
 - 11 b. Laws under which they are incorporated or their banks permit:
 - 12 (1) Withdrawals, loans or advances to owners or sponsors.
 - 13 (2) Stock investment in affiliated corporations.
 - 14 (3) Guarantee of debts of associated corporations.
- 15 6. Letters of intent and letters of credit cannot be used to establish financial capability.
16 At initial endorsement, however, letters of credit may be substituted for cash to set up
17 many of the escrows required at initial and final endorsement, or during construction.
18 If a borrower chooses to use cash at initial closing to satisfy the escrow requirement, a
19 letter of credit cannot be substituted to establish the same escrow requirement.
- 20 7. Ratings and requirements for bank issued letters of credit. When a letter of credit is
21 permitted, the ratings and requirements for banks issuing letters of credit for all
22 multifamily project escrows must meet the following GNMA criteria:
 - 23 a. Unconditional and irrevocable;
 - 24 b. Issued by a bank in a GNMA rated institution which are insured depository
25 institutions, which can include FDIC or National Credit Union Administration,
26 with a rating that is acceptable to HUD (refer to MBS Guide 5500.3 Rev. 1,
27 Chapter 16-8 dated 10/01/09, and Chapter 31-15(B) dated 12/16/2013 for details);
 - 28 c. Is deposited into a non interest bearing account; the institution does not have to be
29 fully insured by the United States of America;
 - 30 d. Valid and collectible; and
 - 31 e. Have a term that equals the period of the escrow or of the borrower's obligation
32 and is acceptable to HUD.
 - 33 f. The format of the letter of credit must follow that in GNMA Handbook 5500.3,
34 REV-1 Appendix VI-3;

- 1 g. The Issuer must be named as beneficiary. The Issuer must execute, in blank, a
2 Transfer of Letter of Credit using the format included in Appendix VI-3, the
3 original of which must be filed with the document custodian; and
4 h. Any substitute letter of credit or extension that changes the letter of credit number
5 or any terms or conditions of the letter of credit will require a new execution in
6 blank and filing of a Transfer of Letter.

7 The requirements for depository institutions and deposit accounts are in found in the
8 current GNMA MBS Guide for Issuers, 5500.3. It is available on GNMA's website
9 at the following link:

10 http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources?Pages?MBSGuideLib.aspx
11
12

- 13 8. The lender of record (as having a financial stake in the borrower's position) may not be
14 the issuer of any letter of credit without prior written consent of the Regional Center
15 Director. Such consent will only be granted on an exception basis with sufficient
16 investigation about a potential conflict of interest. If a demand under any letter of credit
17 is not met immediately, the lender must provide the cash equivalent to the remaining
18 balance of the letter of credit.

19 However, and only in tax credit transactions, if the borrower uses a letter of credit as the
20 form of assurance of completion and also requires a bridge loan, a tax credit syndicator
21 may be the bridge loan lender and the issuer of the letter of credit. In this case the tax
22 credit syndicator represents the borrower's interests (as the equity investors have a strong
23 identity with the borrower.) Conversely the FHA insured lender represents HUD's
24 interest. Subject to a determination of the borrower's creditworthiness, HUD would
25 permit the syndicator to provide both a bridge loan and a letter of credit, so long as the
26 project is not used as collateral.

- 27 9. Lines of Credit. On an exception basis and with prior written consent of the Regional
28 Office Director, existing lines of credit may be used to establish a portion of the
29 principal's financial capability. With the Firm Commitment application, the lender
30 must have the principal provide a letter from a lending institution that confirms:
31 a. The existence of the line of credit, original amount and available balance,
32 repayment terms, and expiration date.
33 b. The line of credit expiration date cannot occur prior to project completion.
34 10. Sponsor's Continuing Commitments.

- 1 a. A written statement must be submitted from principals who are sponsors
2 indicating the parameters of their financial commitment to and contractual
3 relationship(s) with the borrower:
 - 4 (1) If the relationship is not intended to continue until the project reaches
5 sustaining occupancy, the financial requirements have not been met.
 - 6 (2) Any sponsor not having an ownership interest in the borrower entity must also
7 certify in writing the amount it will commit.
- 8 b. The Firm Commitment will contain special conditions to ensure the contractual
9 association of the sponsor to the project:
 - 10 (1) The condition must indicate that the withdrawal of any individual/firm relied
11 on for financial capacity requires prior HUD approval.
 - 12 (2) Identify the individuals/firms relied on for financial capacity. For
13 confidentiality reasons, do not indicate their alphabetic designation or their
14 dollar contribution listed on Form HUD-92264-A.
 - 15 (3) Indicate that the withdrawal of any individual/firm relied on for financial
16 capacity could result in HUD declaring the Firm Commitment null and void.
- 17 c. Require organizational documents reflecting such continuing contractual
18 relationships.
- 19 d. If there is a change in sponsorship of the individuals/firms relied on for financial
20 capacity and the remaining principals do not demonstrate the capacity to meet the
21 financial requirements of the project:
 - 22 (1) At any stage through Firm Commitment this is considered a significant
23 deviation from the original proposal and a cause for rejection of an
24 application.
 - 25 (2) After the issuance of the Firm Commitment, but before Initial Endorsement
26 occurs, this is considered a significant deviation from the application for which
27 the commitment was issued and may be cause for declaring the Firm
28 Commitment null and void.
- 29 11. Individuals are prohibited from submitting financial statements as a sponsor and then
30 abandoning the project and the borrower after the Firm Commitment is issued. The
31 lender should require a certified statement from the sponsor stating their commitment
32 to the project and specifying the amount of funds that will be reserved for contingent
33 needs through Final Endorsement and sustaining occupancy.
- 34 12. The submission of a financial statement that is used to influence Federal Officials
35 concerning a mortgage insurance risk determination when the sponsor does not plan a

1 continuing relationship with the borrower could result in appropriate sanctions being
2 taken against the sponsor including suspension or debarment.

- 3 13. General Contractor with Adequate Capital: The general contractor's adjusted working
4 capital position should equal 5% or more of the estimated construction contract.
- 5 a. The instructions for hypothecation of fixed assets may be applied if the general
6 contractor does not have an acceptable working capital position.
 - 7 b. The general contractor's ability to obtain a performance-payment bond does not
8 negate or lessen this requirement.
 - 9 c. The working capital amount should be adjusted for projects in construction.
 - 10 d. If the general contractor does not have an acceptable working capital position or
11 sufficient fixed assets that can be hypothecated, a joint venture may be established
12 with a financially stronger general contractor provided these firms' combined
13 working capital equals at least 5% of all construction contract amounts for
14 projects in construction and development.
 - 15 e. Waiver of the working capital requirement is reserved to Regional Center
16 Directors, and will only be considered when there are specific strongly supported
17 mitigating factors.

18
19 14. In the case of LIHTC, Historic Tax Credit or New Market Tax Credit
20 transactions, the application may include a *Letter of Commitment* to fund the required
21 equity from a tax credit equity syndicator or investor. This *Letter of Commitment*
22 must specify the equity amount, pay-in schedule and other relevant details such as
23 conditional equity pay in benchmarks, so that HUD and the lender can verify the
24 availability of sufficient equity in a manner that meets HUD's requirements. The
25 syndicator will typically assess the appropriate amounts of reserves at both the
26 property and fund levels and perform certain asset management functions, including
27 the replacement of non-performing general partners. The lender may also require
28 additional documentation (e.g. financial statements, etc.) of a syndicator or investor to
29 demonstrate their ability to make the future equity installments. See Chapter 14 for
30 further guidance on underwriting an application with tax credits.

31
32 The lender should focus on and evaluate the tax credit syndicator's or the direct
33 investor's financial strength, experience, reputation and asset management
34 capabilities, if they have the majority ownership interest in the borrower entity, as
35 addressed in Section 8.3.

- 36
37 15. Real Estate Owned (REO) Schedule and Mortgage Debt Schedule. The purpose of

1 requiring the REO and Mortgage Debt Schedules is to determine a principal's
2 exposure to risk associated with real estate (e.g. multifamily, assisted living,
3 commercial, office, undeveloped land, and new construction versus stabilized
4 properties, etc.). Generally, the REO Schedule lends credibility to asset values
5 reported on the principal's financial statements by requiring detailed information on
6 each real estate asset, and serves as a cross-check to the financial statements. The
7 mortgage debt schedule should include loans that are maturing, or if floating rate debt
8 have resets, within the next 5 years. Other debt that has a material impact on the
9 principals' creditworthiness should be included as well (e.g. if they are in default or
10 are likely to have problems with a loan over the next few years) to determine if any of
11 the properties should be classified as a trouble asset. A troubled asset is one that has,
12 or is likely to default on its mortgage obligations, or has significant financial
13 management or operational problems.

14 a. The requirements detailed in Section 8.7.B, C, & D above, apply to those
15 principals who are actively involved in the property's operating decisions or
16 are significant financial investors as identified in the borrower entity's
17 organization structure. The lender's underwriter must determine which
18 principals have control of the single asset entity and the property, and must
19 assess their financial stability and how it will impact the risk to FHA, and
20 must review their financial statements along with these schedules. Also, the
21 underwriter must analyze and disclose to HUD as part of their
22 recommendation any interests that do not rise to that level, but nevertheless
23 have a material impact on the creditworthiness of the proposed borrower or its
24 principals.

25 b. An analysis of the various properties' net operating income, outstanding
26 indebtedness, cash flow and valuation estimates must detail and support the
27 lender's assessment of the likelihood of the borrower's successfully
28 refinancing projects with maturing balloon debt, assuming current capital
29 markets conditions and current availability of alternative long term financing
30 sources. The analysis should give particular attention to principals with a
31 history or anticipated incidence of adverse credit actions including (but not
32 limited to) bankruptcies, foreclosures or a pattern of renegotiating debt.

33 c. A financing plan should include both conventional financing and other FHA
34 insured loans for any shortfall or anticipated lack of available credit.

- 1 d. An analysis of large nonprofit entities and large for-profit owners with large
2 portfolios and audited summary financial statements is required. Generally,
3 the lender can provide summary data, including a description of exposure to
4 maturing debt obligations, a detailed listing and analysis of troubled projects,
5 including those with recent or anticipated defaults or other material adverse
6 actions.
- 7 e. If a tax credit syndicator is identified, the lender’s underwriter will also need
8 to provide a brief overview and analyses of the entity. Typically a tax credit
9 syndicator is an investor intermediary with only a limited ongoing obligation
10 to LIHTC rental properties. Accordingly an REO schedule is not required for
11 tax credit syndicators or investors. However, the syndicator’s liquidity, track
12 record, asset management and monitoring capability and ability to perform on
13 its commitment to provide equity to the borrower after Initial Endorsement is
14 a material issue for mortgage credit analysis of the tax credit investor/LP. See
15 Chapter 14 for more details.
- 16 f. The lender can present the REO and mortgage debt schedule in tabular format
17 containing the information covered below and any other information sufficient
18 to present their underwriting analysis and conclusions. Typically, the format
19 is a spreadsheet accompanied by a summary description and analysis of each
20 project. When the REO schedule materially differs from the financial
21 statements, and are not minor variations arising from timing of statements or
22 changes in principal balances, then the lender should investigate, reconcile
23 and explain the differences. Refer to Appendix 8A for the itemized physical
24 property list and the schedule of mortgage debt.

1 **Section 8.6 Prior Approval of Principals/Borrowers with Insured** 2 **Balances Greater than \$250 Million or 25 or More Commercial Real** 3 **Estate Assets** 4

- 5 A. Particular attention and additional scrutiny to mitigate risks is given in cases where
6 principals with greater than \$250,000,000 of outstanding FHA insured debt propose to
7 submit loan applications for FHA mortgage insurance. Lenders must perform a thorough
8 mortgage credit review and obtain HUD approval before submission of the application.
9 In cases where principals have greater than \$250,000,000 of outstanding FHA insured
10 debt, the lender must not adjust for a principal's fractional ownership percentage. Based
11 upon the lender's review of the principal's Schedule of Real Estate Owned (REO), the
12 lender must identify principals (including principals/investors with less than 25% of
13 ownership interest) with assets that exceed the \$250,000,000 threshold.
- 14 B. Principals of a borrowing entity with less than a 25% ownership interest but possessing a
15 substantial financial interest and/or having decision making authority will undergo
16 review. This may include the following types of principals:
- 17 a. Investors that have exceeded the \$250,000,000 million threshold and wish to invest in
18 a project as a passive investor with less than a 25% interest.
- 19 b. An investor qualifying as a key financial partner from both a financial strength
20 standpoint and cash requirement contribution but still maintains an ownership interest
21 of less than 25%.
- 22
- 23 C. The lender must first submit their presentation for prior approval to the HUD Regional
24 Center with jurisdiction. The Regional Center will then forward this presentation to
25 HUD Headquarters Office of Multifamily Housing Production for approval and return the
26 approval memorandum to the Regional Center and lender. The presentation must address
27 the following items:
- 28
- 29 1. An analysis of the principal's financial strength, credit history and experience.
30 2. An account of all insured and conventional debt on the REO schedule.
31 3. An explanation of mortgage debt, e.g. type, maturity, age, interest rate.
32 4. A full review and analysis of the operating performance and physical condition of the
33 principal's existing insured properties.

- 1 5. An analysis and projection of the principal’s cash flow and liquidity for the estimated
2 period of time required for proposed insured projects to achieve sustaining
3 occupancy.
4 6. Previous Participation, HUD-2530.
5

6 D. Appendix 8C sets forth the instructions and program requirements for applicants to file a
7 prior approval application to the HUD Regional Center with jurisdiction. The Appendix
8 provides guidance on mandatory and voluntary prior approval, the scope of review, the
9 reviewing authorities, use of the approval once granted, the duration of approval, loan
10 committee actions, lender fees and the appeal process.

11 E. Applicability

12 Prior approval applies to all applications for all MAP multifamily insurance programs,
13 except for refinancing pursuant to Section 223(a)(7). However, in determining whether a
14 principal meets the threshold of insured loans totaling \$250,000,000 or more, lenders
15 must include all FHA insured loans in the total, including healthcare loans (but not
16 including Housing Finance Agency or Government Sponsored Enterprise risk sharing
17 loans).

Section 8.7 Secondary Financing

The amount, form, terms and conditions of any permitted secondary financing is based on the source of funding, as follows. The term of the subordinate loan may not expire before the term of the HUD-insured first mortgage.

A. For all Sections of the Act (SOA), when secondary financing is provided by a federal, state or local governmental source:

1. The subordinate loan must be secured by a promissory note and mortgage lien as prescribed by the governmental funding source and reviewed and approved by HUD. Use of HUD Form 92420-M entitled Subordination Agreement is required.
2. Secondary financing (or grants lent to the property as a secondary loan) may be used to offset up to 100% of the applicable SOA equity requirements, and may also be used to finance non-mortgageable costs, which when added to the HUD mortgage and required equity contribution, may exceed 100% of the project's Fair Market Value (FMV) or Replacement Cost.
3. Non-mortgageable costs (i.e. replacement cost items, not eligible for inclusion in the HUD insured loan to be offset by the secondary financing), must be certified by the funding source to be reasonable and necessary to complete the project. Documentation to this effect must be included with the application submission.

B. When Secondary Financing is From a Private Source – Section 223(f)

1. Secondary financing from a private lending source must be evidenced by a promissory note, which may not be modified or altered in any manner without the written consent of HUD. The secondary financing note must be accompanied by the required secondary financing rider; a sample of the rider is found in the Multifamily Program Closing Guide as Part 5.1.

Private secondary financing is permitted to offset mortgageable and non mortgageable costs up to the difference between the loan-to-value percentage and a maximum of 92.5% of the FMV, except in instances when private secondary financing is combined with federal, state or local governmental agency secondary financing. In these instances, the governmental loan, in aggregate with the HUD first and private second, may exceed the property's FMV. Further exceptions are made for Low Income Housing

1 Tax Credit transactions, in which secondary debt may equal but not exceed 100% of
2 project costs. (See Chapter 14 for details.)
3

- 4 2. Private secondary financing up to 92.5% total LTV (including both HUD-insured and
5 private secondary financing) may be secured by a lien encumbering the real property.

6 NOTE: Except for the limited instance in Section 8.7.B.4 below, secondary financing
7 from private sources is not permitted under any other SOA.

- 8 3. Mezzanine Financing. Mezzanine financing is a subordinate loan usually secured
9 by a pledge of ownership interests rather than by a secondary lien on the real
10 estate, the existence and terms of which must be fully disclosed to and approved
11 in writing by HUD. Any mezzanine debt that remains from a previous financing
12 of the property is subject to the secondary financing guidance in this section.
13 Payments on mezzanine financing can only be made from surplus cash and the
14 debt cannot mature before the maturity date of the FHA insured loan. Mezzanine
15 loan interest rates will typically be higher than that of the first mortgage, but must
16 be reasonably consistent with market rates for mezzanine debt. Additionally the
17 interest rate must not be so high that it jeopardizes the ownership stability of the
18 property, or that the interest due cannot reasonably be expected to be repaid from
19 surplus cash. Interest due or accruing on the mezzanine loan must be approved as
20 reasonable by HUD.

21 In the event of nonpayment or default on the mezzanine debt, any transfer of an
22 ownership interest in the borrower entity or in its principals to the mezzanine
23 lender must have prior written approval by HUD, through the Transfer of Physical
24 Assets (TPA) process. The mezzanine lender can exercise no enforcement
25 remedies as against the real estate or as against the borrower entity during the
26 term of the mezzanine loan, nor can the lender take action which would trigger a
27 Transfer of Physical Assets (TPA) without HUD approval.

28 NOTE: Project specific exceptions or waivers to these policies for mezzanine
29 financing must be approved by Headquarters and documented in writing.

- 30 4. New Construction/Substantial Rehabilitation Programs. Private secondary financing
31 is not permitted under Section 221(d)(4) or other new construction/substantial
32 rehabilitation first mortgage programs. The only exception to this consideration is

1 Seller financed secondary debt (aka seller take back note). The Seller financed
2 secondary debt must meet both of the follow criteria:

3 a) The FHA loan to value is less than 50% (80% LTV for tax credit applications) of
4 the mortgageable cost, and

5 b) The Seller financed secondary debt is either:

6 i) An arms-length transaction; or

7 ii) It involves an identity of interest transaction such that the selling price of the
8 land or building must not be greater than the property's "as is" value."

9 In either case the seller financed subordinate debt must meet all of the following
10 conditions as well as those set forth in paragraph C below:

11 a) It is an inferior cash flow debt, e.g. only payments from up to 75% of surplus
12 cash, if available;

13 b) It is documented in a promissory note that is not recorded and not secured with a
14 lien against the property;

15 c) It does not contain any provision of foreclosure that would threaten the first
16 mortgage;

17 d) It is subject to automatic re-subordination in any subsequent refinancing of the
18 first mortgage; and

19 e) Balloon payments on subordinate debt prior to maturity of the FHA-insured first
20 mortgage are generally prohibited.

21 5. Section 223(a)(7) Refinance Program. For Section 223(a)(7) applications, secondary
22 financing terms are governed by the SOA of the underlying insured mortgage, but
23 shall not be used directly or indirectly to provide funds for an equity takeout or a
24 Transfer of Physical Assets.

25 C. Commitment Condition for Repayment of Public or Private Secondary Financing.
26 Repayment of secondary debt, including interest, must be made solely payable from up to
27 75% of available surplus cash. Use Form HUD-92223M. Include the following
28 language in the secondary financing promissory note:

29 *"So long as the Secretary of Housing and Urban Development or his/her successors or*
30 *assigns, are the insurers or holders of the first mortgage on (**insert project name and***
31 ***FHA Project No.**), payment(s) due under this Note shall be payable from up to 75% of*
32 *available surplus cash. Non-project sources that are outside the Mortgaged Property*

1 *may also be used to repay subordinate financing. The term surplus cash is defined in the*
2 *Regulatory Agreement dated (**insert date**) between HUD and (**insert name of borrower**).*
3 *The restriction on payment(s) imposed by this paragraph shall not excuse any default*
4 *caused by the failure of the maker to pay the indebtedness evidenced by this Note."*

5 This language does not need to be added to the Subordination Agreement (See HUD-
6 92420M) or the Secondary Financing Rider in the Multifamily Program Closing Guide at
7 Part 5.1.)

8 D. Secured Public Secondary Financing Conditions. The borrower may secure a Promissory
9 Note with a subordinate lien from a governmental agency against the property under the
10 following conditions:

- 11 1. The lender on the insured mortgage must consent to the placing of the subordinate
12 lien and agree that its existence does not constitute a basis for default on the first
13 mortgage.
- 14 2. There must be a simultaneous closing and same day recordation of the subordinate
15 financing documents and the insured first mortgage loan documents.
- 16 3. The terms of the subordinate mortgage must be:
 - 17 a. Approved by the Field Counsel;
 - 18 b. Consistent with the terms of the insured Surplus Cash Note, the first mortgage,
19 the Regulatory Agreement and all HUD regulations and requirements.
 - 20 c. The subordinate mortgage shall not contain a cross default provision or any right
21 of foreclosure before the termination of the FHA insured mortgage.
 - 22 d. The term of the subordinate mortgage must be extended, if:
 - 23 (1) The Promissory Note matures, there are no surplus cash funds or residual
24 receipts available for repayment and the first mortgage has not been repaid in
25 full. (Distribution of residual receipts can only be approved by the terms of a
26 written agreement between HUD and the owner.)
 - 27 (2) HUD grants a deferment of amortization or forbearance that results in an
28 extended maturity of the insured mortgage.
 - 29 (3) The maturity date of the subordinate mortgage is less than the term of the
30 FHA-Insured mortgage.
 - 31 e. The subordinate mortgage must be assumable when a sale or transfer of physical
32 assets occurs and the insured mortgage remains in place.
 - 33 (1) The holder of the subordinate mortgage cannot require that more than 75% of
34 the net proceeds of the sale or transfer be applied to the reduction of the loan.

- 1 (2) For these instructions, net proceeds are the funds available to the original
2 borrower after:
3 (a) Correcting any monetary or covenant default on the first mortgage.
4 (b) Making:
5 (i) Required contributions to any reserve funds.
6 (ii) Needed improvements to the property as evidenced by HUD's annual
7 inspection reports.
8 f. The subordinate mortgage must automatically terminate if HUD acquires title to
9 the project by a deed in lieu of foreclosure.
10 g. No more than 75% of surplus cash can be pledged to the repayment of the
11 subordinate loan(s).
- 12 E. Unsecured Private Secondary Financing Conditions. Terms of unsecured private
13 Promissory Notes must reflect those provisions found in: Form HUD-91710M, Residual
14 Receipts Note [Non-profit Borrower], or Form HUD-91712, Residual Receipts Note
15 [Limited Dividend Borrower], or Form HUD-92223M, Surplus Cash Note [Profit
16 Motivated Mortgagors] based upon the type of borrower; or must include the terms set
17 forth in the Secondary Financing Rider. See the Multifamily Program Closing Guide,
18 Part 5.
- 19 1. Form HUD-91710M, Residual Receipts Note (for Non-profit Mortgagors) and Form
20 HUD-91712M, Residual Receipts Note (for Limited Dividend Mortgagors).
- 21 a. Principal and interest shall be due and payable on or after the maturity date of the
22 HUD-insured mortgage.
- 23 b. If the HUD-insured mortgage is prepaid in full, the holder of the residual receipts
24 note has the right to declare the entire principal sum or any remaining balance
25 including any accrued interest immediately due and payable.
- 26 c. Prepayments to principal and interest:
- 27 (1) may be made (a) from the residual receipts as defined in the Regulatory
28 Agreement only after obtaining written approval from HUD or (b) from sources
29 other than Project Income or Project Assets, e.g., syndication proceeds.
- 30 (2) may be made only after final endorsement of the insured mortgage and after
31 the end of a semiannual or annual fiscal period.
- 32 (3) if unauthorized prepayment is accepted, the funds shall be returned to the
33 Project immediately upon discovery.

1 d. The residual receipts note is nonnegotiable and may not be sold, transferred,
2 assigned, or pledged by the payee.

3 e. Presentation, demand and notice of demand, nonpayment and protest of the
4 residual receipts note are waived.

5 f. Interest on the note must not be compounded.

6 2. Form HUD-92223M, Surplus Cash Note (for all other mortgagor entities; formally
7 called the Promissory Note). The conditions and limitations are the same as Form
8 HUD-91710M, except that:

9 a. Provisions may be made for interest payments annually or semiannually or at the
10 end of a fiscal period. However, terms of the Note should include the fact that interest
11 accrues and is payable in full when the Note matures.

12 b. Prepayment of principal or any payment of interest must be limited to sources
13 other than Project Income or Project Assets, e.g., syndication proceeds or surplus cash
14 as defined in the Regulatory Agreement.

15 c. Payments on promissory notes will be made only as permitted by the applicable
16 Regulatory Agreement, but prepayment of the promissory notes from sources other
17 than the project is permitted without HUD approval.

18 d. Should any unauthorized prepayments be made, as determined by HUD, it shall
19 be the responsibility of the borrower to return them to the project.

20 e. Interest on the Note must not be compounded.

21 F. Tax Credit Equity Bridge Loans.

22 Tax credit equity syndicators or investors (with or without an identity of interest with the
23 MAP Lender) may make bridge loans to fund LIHTC, Historic or New Markets Tax
24 Credit equity for projects during the construction or substantial rehabilitation period and
25 stabilization period as described in Chapter 14.16.

26 A bridge loan may be used to secure the sponsor's cash contribution required to complete
27 construction before the Tax Credit syndication proceeds are paid in by the investor. The
28 placed in service date is the date when the newly constructed or rehabilitated property has
29 been completed and its units have been occupied by low income qualified residents. This
30 is also when the LIHTCs are officially available to be claimed by the equity investor,
31 and is evidenced by issuance of IRS Form 8609, Low-Income Housing Credit Allocation

1 and Certification. Accordingly the delivery of the form 8609 to investors, or one year
2 later if approved by HUD, is the date at which LIHTC project bridge loans must be paid
3 in full.

4 G. Identify all subordinate loan funds in Section III “Source of Funds to Meet Cash
5 Requirements” Form HUD-92264-A.
6
7

DRAFT

Section 8.8 Required Application Processing Exhibits and Lender and HUD Responsibilities

The lender shall utilize HUD's standardized application exhibit checklist to facilitate the electronic submission of the application to aid in HUD's completeness review of deliverables and to record underwriting processing results and conclusions for both pre-application and firm applications. The standardized checklist is a concise structured template organized with separate sections directly related to each technical discipline. The template will permit the HUD-delegated underwriter and lender to locate exhibits within the application binder, which will in turn expedite the application review process while reducing HUD's risk during the underwriting analysis of the application. These application templates are for use for all programs applications submitted under the Multifamily Accelerated Processing with the exception of Section 223(a)(7) applications. The lender's application submission templates for mortgage insurance are:

1. Underwriter's Narrative
2. Application Checklist
3. FHA Summary Report (The Wheelbarrow)

A. General Responsibilities of Lender's Underwriter

Underwriting multifamily projects is a process for evaluating the character, capacity and creditworthiness of the sponsor, borrower and its principals, the property management company and the general contractor in order to reach specific conclusions resulting in the approval (with conditions, as appropriate) or denial of a mortgage insurance application.

The Lender must assess the borrower's ability to manage all of the responsibilities of the ongoing operations of multifamily properties, including the development, construction, completion, and lease-up for new construction proposals and property maintenance, tenant relations, financial and performance reporting and effective management for existing properties.

The lender's underwriter must:

1. Identify the borrower and its principal entities or individuals and present a complete, consistent and coherent picture of the financial capacity and creditworthiness of the borrower and the various principals.
2. Analyze the creditworthiness of the sponsor(s), the borrower entity, if formed, and its principals and/ or individuals and the contractor. If a borrowing entity is not yet formed at the

1 time the firm application is submitted, the MAP Underwriter must still perform the financial and
2 credit analysis on the principals and/or individuals. The underwriter must demonstrate that the
3 principals and/or individuals have the character, capability, creditworthiness and commitment to
4 provide expert leadership, working capital and cash needed to close the proposed transaction(s),
5 complete the development process, as applicable, and to support the operations of the property.
6 This determination is made in light of the obligations that may already be required of the
7 principal due to ownership of other business interests and real estate projects.

8
9 3. For existing mortgagor entities and properties, evaluate the financial performance of the
10 mortgagor and the property based on its financial statements and other operating reports, (e.g.,
11 rent rolls) and credit history to determine eligibility, mortgage amount and conformance to
12 program requirements.

13
14 4. Conduct a mortgage credit review to include:

- 15 a. The balance sheets for principals as discussed in Appendix 8C, “Analyzing Financial
16 Statements.”, and in addition to other relevant schedules, the Schedule of Real Estate
17 Owned per Chapter 8.7.D.15 of the MAP Guide.

18
19 In each case the lender will conduct sufficient diligence to determine what should be an
20 appropriate period of past financial review. Character is best demonstrated during periods
21 of economic distress and so a review of at least one complete business cycle is necessary.
22 Any material credit problems in the last 2 to 5 years should be carefully reviewed and
23 may result in an application rejection. Events that occurred before that period if, for
24 example more than 8 or 10 years have passed, would not have as material an impact on
25 creditworthiness but may still be relevant. The lender should consider all relevant factors
26 in the analysis and credit approval decision.

- 27
28 b. Determine whether the sponsor(s) has (or will have, given proposed transactions) existing
29 insured mortgage balances exceeding \$250,000,000. If a sponsor has obtained prior
30 approval to exceed this amount, submit a copy of the Prior Approval Decision together
31 with any other documents identified as required by the Prior Approval Decision. (See
32 Appendix 8C for prior credit approval instruction.)

33
34 5. Determine if there is incomplete or inconsistent information, or discrepancies between

1 the information included on the financial statements and in the credit reports. Any
2 inconsistencies must be reconciled.

3
4 6. In addition to the formal documents and credit investigation described above, the
5 lender's underwriter must conduct and describe the results of an internet search of each
6 principal and determine if there is any information that raises concerns about credit worthiness
7 and address any negative information.

8
9 7. Provide the Office of Foreign Assets Control (OFAC)/Terrorism checks and verifications
10 on principals which are required by the U.S. Patriot Act. These checks must be completed and
11 documented no later than the time of Initial Endorsement, whether or not the lender is a
12 regulated financial institution. The OFAC verification is not part of MF Regional/Satellite
13 Office review except to the extent that the lender has identified problems during the OFAC
14 check. OFAC requirements are administered by the Department of the Treasury and lenders
15 should refer to the Treasury's website <http://www.ustreas.gov/offices/enforcement/ofac>, for any
16 questions.

17
18 *B Additional Required Exhibits of Project Participants*

19
20 The borrower shall provide the following exhibits for the following participants:

21
22 1. Exhibits required for participating professionals, officers of corporations:

23
24 a. Identity of Interest of Borrowers Using BSPRA - General contractors with an
25 identity of interest with the borrower may be either independent businesses
26 with an ownership interest created in the borrower entity primarily to obtain
27 the Builders and Sponsors Profit and Risk Allowance (BSPRA) or businesses
28 owned and operated by a principal of the borrower. Notwithstanding any
29 identity of interest, the general contractor is required to provide the identical
30 exhibits as a participant.

31
32 b. Management Agent - A detailed resume is required for management agents
33 even when they have no ownership interest in the borrower or identity of
34 interest with a principal. Credit reports should be required of management
35 agents to evaluate the agent's business practices and timely payment of
36 accounts. Analysis of financial statements is generally not required, unless the

1 agent has an identity-of-interest with a principal, or where financial statements
2 are necessary to evaluate the capacity of the management entity to perform its
3 management role.

4
5 c. Fee Developer/Consultant - Fee developers, packagers, consultants and other
6 professional persons or organizations are sometimes retained to assist
7 nonprofit sponsors that might lack needed experience. Such services might
8 include assisting with project development, financial structuring or HUD
9 processing. These professionals must provide resumes evidencing their
10 qualifications, and credit reports and financial statements when their services
11 are critical to project viability.

12
13 d. Design Architect/Engineers - Design professionals must provide resumes
14 establishing their credentials, competence and experience commensurate with
15 levels of expertise and experience required by the project. Absent an
16 ownership interest in the borrower that would otherwise qualify the design
17 professional as a principal, no other mortgage credit exhibits are required.

18
19 e. Executive Officers of Borrower - Officers with less than 10% of the voting
20 stock of a profit motivated corporation but is a principal of the borrower may
21 be required to submit resumes and demonstrate appropriate competence and
22 experience if necessary to provide an accurate picture or character, capacity
23 and commitment.

24
25 f. Executive Officers and Directors of Publicly Traded Corporations - are not
26 required to submit mortgage credit exhibits as individuals, notwithstanding
27 their stock ownership inasmuch as such firms are regulated by the U.S.
28 Securities and Exchange Commission (SEC). The SEC required annual
29 corporate report (Form 10-K) and quarterly corporate report (10-Q) provides
30 complete financial statements, background and history of corporate operations
31 as well as resumes and compensation of corporate officers and disclosure of
32 conflicts of interest of officers and directors. In addition the credit of publicly
33 traded corporations is rated by agencies such as Standard and Poor's, Fitch
34 and Moody's. When a publicly traded corporation is a principal, Forms 10-K
35 and 10-Q and agency credit ratings may be accepted in lieu of mortgage credit
36 exhibits.

1
2 *C Evaluating Nonprofit Sponsors and Borrower*

3 A. General

4 Nonprofit borrower/sponsors (whether national, regional, or local) must have the
5 experience and financial strength appropriate for the development and ownership of the
6 proposed property. (Appendix 8.D. sets forth the evaluation of the nonprofit.) The
7 nonprofit sponsor being evaluated may not have equal strength with respect to all criteria.
8 In transactions where the borrower/sponsor's ownership structure contains multiple
9 entities performing differing functions, the lender must evaluate the nonprofit and each of
10 the other entities on their capacity to perform its particular function, e.g. ownership,
11 property management, acquisition, development, resident services or asset management.
12 This includes the need for prior acceptable history of successful development, ownership
13 and management of assets similar in size and complexity as the proposed project.
14 Therefore, only the criteria for the areas in which the nonprofit entity has direct
15 responsibility or authority need to be applied during the evaluation process. The
16 eligibility of prospective nonprofit sponsor/borrower must be determined before a Pre-
17 application approval or Firm Commitment is issued.

18 The lender must include in the Underwriter Narrative summary. A description of the
19 party paying pre-development costs.

- 20 1. Details of any proposed rent/income restrictions on the property to be developed by
21 the nonprofit.
- 22 2. Developer's Agreement or any other document which shows the relationship and
23 work responsibilities of all parties associated with the transaction.
- 24 3. Explanation of the terms and conditions of the Housing Consultant's contract, if
25 applicable. The fee for the Housing Consultant shall be an expense of the borrower.
- 26 4. Memorandum of findings and recommendations.
- 27 a. Must include a description of the relationship between the nonprofit and any
28 profit motivated entities involved in the transaction.
- 29 b. The determination of eligibility or ineligibility of the nonprofit sponsor/borrower
30 must be approved by the HUD office with jurisdiction.
- 31 6. Explain any nonperforming assets in nonprofit borrower/sponsor portfolio in
32 conjunction with the REO review.

- 1 7. Detailed explanation of the motivation for sponsoring the project including a history
2 of the organization's involvement in multifamily housing.
- 3 8. The property manager must have a minimum of 3 years of experience in managing at
4 least 5 properties comparable to the proposed property in scale, complexity and
5 regulatory compliance requirements. A property manager must demonstrate adequate
6 property management experience with properties comparable to the subject property.
- 7 9. Signed written resolution of the nonprofit's directors or trustees, acknowledging the
8 responsibilities and obligations of sponsorship and continuing ownership, and that the
9 subject proposal reflects the will of the board and/or the membership of the
10 organization.
- 11 10. Detailed statement of arrangements made or proposed for the following (listing
12 principals involved, their relationship with the nonprofit sponsor/borrower, the terms
13 of the arrangements and the circumstances surrounding each):
 - 14 a. Land on which the project will be built.
 - 15 b. Project construction, including selection of general contractor, subcontractors and
16 architect.
 - 17 c. Legal and consulting services.
 - 18 d. Project financing, including any discounts.
- 19 NOTE: A national, State or regional organization acting as a cosponsor must submit
20 a separate Form HUD-3433 and Supplemental documentation.
- 21 11. The nonprofit sponsor must have diverse and stable funding sources with recurring
22 revenue and, if required, a proven record of raising sufficient funds to meet its
23 operating needs. The lender must identify whether the nonprofit sponsor's primary
24 funding sources are from fees on development projects or from sources such as public
25 funding, public contracts, grants or donations that may be subject to budget or
26 funding constraints.
27

28 **B. Mortgage Credit of the Nonprofit Sponsor and Borrower.**

- 29 1. The underwriter narrative should summarize the review of Form HUD-3433 to
30 determine if the nonprofit sponsor/borrower is qualified to start, complete and operate
31 a project under the insured loan programs. The lender must determine that the
32 nonprofit sponsor/borrower is acting on its own behalf, or if either knowingly or
33 unwittingly acting under the influence, control or direction of any outside party
34 seeking to derive a profit or gain from the proposed project—such as a landowner,
35 real estate broker, contractor, architect, attorney or consultant.

- 1 2. Credit investigation analysis.
- 2 a. As with for-profit sponsors, the lender's underwriter must make a determination
- 3 of the individuals and entities with decision-making and operational authority
- 4 over the project. The underwriter will provide an in-depth written analysis on the
- 5 aspects of the mortgage credit review in the underwriter's narrative.
- 6 b. Check that the borrower/sponsor has no unresolved issues related to payment
- 7 history and check credit references.
- 8
- 9 3. Financial data analysis.
- 10 a. Determine the amount of cash and liquid assets available for investment in the
- 11 project and overall financial condition of the sponsoring group, and in particular
- 12 whether the financial statements indicate that income will be sufficient to meet the
- 13 expenses incurred by the group.
- 14 b. Financial statements of many large nonprofit organizations show various fund
- 15 accounts, such as general and building fund, etc.
- 16 (1) Identify any inter-fund receivables and payables that cancel each other.
- 17 (2) Do not consider restricted-use funds in the analysis.
- 18 (3) Review the Public Records section of the credit report to eliminate assets,
- 19 which were used as collateral in secured borrowing.
- 20 c. The project size and complexity should be consistent with the abilities of the
- 21 sponsoring organization.
- 22 C. Submitting Form HUD-3434, Certificate of Relationships and Non-profit Motives, and
- 23 3435, Certification of Contractual Relationship.
- 24 1. At the Firm Application stage and prior to initial endorsement (beginning of
- 25 construction in the case of insurance upon completion), the sponsor and borrower
- 26 must certify on Form HUD-3434, their relationships with parties or firms furnishing
- 27 land and services.
- 28 2. Such parties or firms must certify on Form HUD-3435 their relationship with the
- 29 sponsor and borrower.
- 30 3. If there is a change in the certified relationship, the sponsor, borrower and other
- 31 parties must furnish additional certifications with respect to each change.
- 32 4. All relationships are subject to HUD approval.
- 33 D. Nonprofits may earn a developer's fee, but not BSPRA, on a new construction or
- 34 substantial rehabilitation proposal under Sections 220, 221(d)(4), 231, or 241(a).

1 E. Nonprofit Sponsor and a Profit-Motivated Borrower Entity.

2 A nonprofit sponsor may establish a profit-motivated borrower entity for the purpose of
3 owning a tax credit project or obtaining BSPRA and distributions from surplus cash.

4 Such a request may be approved provided:

- 5 1. The Field Counsel determines that there is no legal impediment that would prohibit
6 approval of the request.
- 7 2. The nonprofit agrees to be regulated by the terms and conditions of the regulatory
8 agreement (Form HUD-92466M, Regulatory Agreement Multifamily Housing
9 Projects) applicable to a profit-motivated entity.
- 10 3. The nonprofit is subject to the mortgage limitations applicable to a profit-motivated
11 entity.
- 12 4. A working capital deposit is required.
- 13 5. A nonprofit developer's fee is not included in the mortgage.
- 14 6. If the nonprofit provides evidence that it has obtained exemption from real estate
15 taxes, the tax exemption must run with the real estate and not with the type of
16 sponsorship.
- 17 7. The potential tax consequences, as well as the possible effect on the nonprofit's Section
18 501(c)(3) status with the IRS, is determined to be acceptable.
- 19 8. Form HUD-3433 is not required in these types of applications

20 ***D Lender's Review and Recommendation***

21
22 The lender's underwriter's recommendation, after review of all processing materials and third
23 party reports, is made in a separately bound report addressed to HUD included in the
24 underwriter's narrative.

25 A. The report must detail the project's financial requirements and the credit capacity of the
26 sponsors, borrower entity, its principals and the general contractor. The lender's
27 underwriter's narrative must detail the project's financial feasibility with an analysis of
28 the primary risks, any mitigating factors, and the rationale for any waivers requested.
29 The mortgage credit analysis must contain evidence of the financial feasibility and
30 acceptability of the single asset entity, of each principal with decision making control and
31 of investors providing funds for initial closing. Include, at a minimum, the:

- 32 1. Name of the borrower entity.

- 1 2. Composition of the borrower entity, include the tiers showing principals with control
2 and providing the financing.
- 3 3. Name of the general contractor, disclosing any relationship(s) with the borrower
4 entity.
- 5 4. Mortgage amount and controlling criterion.
- 6 5. Financial requirements for closing.
- 7 6. Sources of funds to meet cash requirements, including all sources and disclosing how
8 the money will be used.
- 9 7. Ratio of loan proceeds to actual cost for the purpose of cost certification.
- 10 8. The experience level of the development team relative to the proposed project.
- 11 9. A credit and financial review of sponsor(s)/borrower and principals and general
12 contractor. This review must provide an overview of their financial strength,
13 liquidity, experience, and creditworthiness and address positive and negative findings
14 known by the lender.
- 15 10. Bonding requirements.
- 16 11. Recommendation to accept or reject the proposed project.
- 17 12. If accepted, any conditions to be included in the commitment. (See Chapter 11)
- 18 B. Complete Form HUD-92264-A and exhibits for the type of mortgage proposed.
- 19 C. The lender must transmit to HUD all borrower submissions and related documents.
- 20 The lender will analyze the stability of the principal's portfolio ownership and management
21 structure, portfolio characteristics and market conditions and recommend prior approval of
22 creditworthiness. The analysis shall include:
23 24 25 1. Review of the stability of ownership and management.
26 27

2. Evaluation of any problems and challenges confronting the principal and the principal's plans for action in response to such challenges including:

- a. Underperforming properties, (e.g., properties at less than 90% occupancy; properties at less than 1.1 to 1 debt service coverage; properties with significant physical or management problems).
- b. Existing defaults and/or pending capital transactions, (e.g., anticipated refinancing or refunding, pending balloon payments, interest rate resets)
- c. Property or Asset Management deficiencies, (e.g., underfunded reserves, deferred management fees).
- d. Suits, judgments, liens or related adverse actions.
- e. Weak or unstable markets affecting geographically concentrated properties or other actual or prospective adverse conditions affecting a unique combination of assets and the impact of such conditions on the portfolio.
- f. A determination whether the principal's reputation, past performance and capacity support a conclusion that insured assets will be maintained in good physical condition, with timely capital replacements and prompt, effective action to remedy problems.

F Mortgage Credit Duties of HUD

- a. Concentrated Risk Prior Approval - Confirm that the lender has correctly determined if prior approval is required for the sponsor to file an application. (See Appendix 8.C. for prior credit approval instruction).
- b. Previous Participation - Perform the electronic 2530 review and approval process.
- c. Underwriting Conclusions - Review lender's preliminary analysis and recommendation about the Development Team's financial capacity, experience and creditworthiness and the lender's analysis of any defaults, mortgage relief, assignments, and foreclosures relating to these projects.
- d. Verify Sources of Funds - HUD will verify, through use of the Form HUD-92264-A and documents supplied by the lender, the source(s) of funds to meet cash requirements

Section 8.9 Term of Mortgage and Commencement of Amortization

A. For Sections 220, 221(d)(4), 241(a) and 231 projects:

1. The term of the mortgage is the lesser of 75% of the estimated remaining economic life of the physical improvements or 40 years from the date of the first payment to principal.

a. Express the mortgage term in whole or partial years.

2. Express a partial year in months, for example 26 years, 3 months.

3. Amortization starts:

a. For Insurance of Advances projects, no later than 4 months after the date of construction completion as estimated in the Firm Commitment.

b. For Insurance Upon Completion project, the first day of the second month following the date of Final Endorsement.

B. For Section 207 pursuant to 223(a)(7), 223(f) projects:

1. The term of the mortgage shall not be less than 10 years, nor shall it exceed the lesser of 35 years or 75% of the estimated remaining economic life of the physical improvements.

a. The mortgage term shall be the eligible number of whole or partial years between 10 and 35.

b. Express a partial year in months, for example 26 years, 3 months.

2. Amortization starts on the first day of the second month following the date of the Initial/Final Endorsement of the mortgage for insurance.

Section 8.10 Sections 220, 221(d), 231, 241(a) Firm Commitment Processing: Determining Mortgage Amounts, Cash Requirements and Related Items

A. Firm Commitment Processing.

1. New Construction Loan Limits. For new construction, the insurable loan amount is the lowest of four criteria on Form HUD-92264-A, Supplement to Project Analysis: the application amount, the cost amount, the statutory limits amount, and the debt service amount, which are described below. Refer to Chapter 3 for the applicable program required maximum loan ratios and the debt service coverage ratios needed to complete criteria for new construction and substantial rehabilitation firm applications.

a. The Application amount.

b. Amount Based on Value or Replacement Cost. The result of lender's estimate of the replacement cost after completion, multiplied by the applicable percentage.

c. Amount Based on Limitations Per Family Unit - Statutory Limits. An amount attributable to dwelling use, excluding land, not to exceed the per unit limits as adjusted by the High Cost Percentage (HCP) for the jurisdiction in which the project will be located, plus the percentage loan ratio noted in A.1 above, times the sum of costs not attributable to dwelling use (from Form HUD-92264 Section M Line 15) and the warranted price of the land (from Form HUD-92264 Section G Line 73a) (or the "as is" value of the building without the improvements if the transaction is a substantial rehabilitation loan, from Form HUD-92264-HCF Section H Line 38). Per the unit limits and High Cost Percentages can be obtained on the HUD web site at: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/mfinfo.

d. Amount Based on Debt Service Limit. The loan amount supported by the applicable percentage of projects' estimated net income.

The NOI used to support this mortgage criterion may be split into two or more income streams, for example to capitalize the savings from tax abatement or to recognize other revenue sources such as from an IRP decoupling.

(1) That portion of the maximum mortgage supported by the tax abatement or other source of must be amortized over the same period as the additional NOI as available.

1 (2) Any tax abatement must run with the real estate and not with the type of
2 sponsorship in order to be recognized in the mortgage proceeds.
3

4 2. Substantial Rehabilitation Loan Limits. Amount of Loan – Rehabilitation under Section
5 220 and 221(d). (This includes only projects involving substantial rehabilitation or
6 reconstruction.) The insurable loan amount is the lowest of four criteria on Form HUD-
7 92264-A, Supplement to Project Analysis: the application amount, the cost amount, the
8 statutory limits amount or the debt service amount, as described below. Refer to Chapter 3
9 for the applicable program required maximum loan ratios and the debt service coverage
10 ratios needed to complete the criteria for substantial rehabilitation firm commitment
11 applications.
12

13 a. The Application amount.
14

15 b. The lender's estimate of the rehabilitation cost plus the fair market value of the land and
16 existing improvements before rehabilitation, multiplied by the applicable percentages in
17 Chapter 3.
18

19 c. Amount of Loan – Rehabilitation under Section 231. (Only for projects involving
20 substantial rehabilitation or reconstruction.) The amount as permitted under the new
21 construction program except the loan limitation is based on the estimate of value rather than
22 the replacement cost. The insurable amount is the lowest of:

23 (1) The application amount;

24 (2) Property owned – 100% of the estimated cost of rehabilitation plus the lesser of:

25 (a) Principal amount of existing indebtedness against the property and closing charges, or

26 (b) For all borrowers, apply the amounts in Chapter 3, to calculate the lender's estimated
27 appraised value of the property before rehabilitation and closing charges less:

28 (i) Value of leased fee, if leasehold, and/or

29 (ii) Principal amount of special assessment
30
31
32

33 (3) Property to be acquired – For all borrowers apply the amounts in Chapter 3 to calculate
34 of the lender's estimated current cost of rehabilitation/reconstruction plus the lesser of:
35

36 (a) Apply the amounts in Chapter 3 for all borrowers to calculate the actual
37 purchase price of the property and closing charges, or

1 (b) For-profit borrowers, apply the amounts in Chapter 3, of the lender's
2 estimated appraised value of the property before rehabilitation and closing
3 charges and/or principal amount of special assessment.
4

5 **B. Insurance of Advances and Related Matters.**

6 See Section 12.7 and Appendix 12 for processing instructions.
7
8

DRAFT

1 **Section 8.11 Sections 223(a)(7) and 223(f) Firm Commitment** 2 **Processing: Determining Mortgage Amounts, Cash Requirements and** 3 **Related Matters**

4 A. Firm Commitment Processing for Section 207 pursuant to 223(f):

5 1. Amount of loan in a purchase transaction.

6 In a purchase transaction involving an arm's length sale, the mortgage may not
7 exceed the lowest of 5 criteria on Form HUD-92264-A, Supplement to Project
8 Analysis: the application amount, the loan to value amount, the statutory limits
9 amount, the debt service amount, and the cost amount, which are described below.
10 Refer to Chapter 3 for the applicable maximum loan ratios and the debt service
11 coverage ratios needed to complete criteria for a firm purchase application.

12 a. Application amount.

13 b. Loan to Value Ratio amount. Refer to Chapter 3 for ratios. These loan-to-values
14 apply to both for-profit and nonprofit borrowers. (The amount based on value for
15 Section 202 or 202/8 Direct Loan purchase transactions is 90%.)

16 c. Statutory Limits Amount. This limit is based on maximum costs. The maximum
17 per family unit limitation for new construction under Section 207 may be
18 increased by the percentage of the HCP plus the percentage loan ratio noted in
19 A.1.b, above, cost not attributable to dwelling use, from Section M Line 15 of the
20 Form HUD-92264 and the "Warranted Price of Land." This corresponds to
21 Section G Line 73a of Form HUD-92264, Multifamily Summary Appraisal
22 Report.

23 NOTE: Per family unit limits may be increased the HCP. The per unit limits and
24 High Cost Percentages can be obtained on the HUD web site at:

25 http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/hicost/hicost
26 [cost](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/hicost/hicost).

27 d. Debt Service Amount. The loan amount supported by the applicable percentage
28 of the projects' estimated net operating income (NOI). The mortgage may exceed
29 this limit by capitalizing the savings from any tax abatement. In such cases, the
30 net earnings estimate will not reflect that temporary tax abatement.

1 The NOI used to support this mortgage criterion may be split into two or more
2 income streams to capitalize the savings from tax abatement or to recognize other
3 revenue sources such as from an IRP decoupling.

4 (1) That portion of the maximum mortgage supported by the tax abatement or
5 other source of must be amortized over the same period as the additional NOI
6 as available.

7 (2) Any tax abatement must run with the real estate and not with the type of
8 sponsorship if it will be recognized in the mortgage proceeds.

9 e. Acquisition Cost. The applicable percentage from Chapter 3 must be applied to
10 the borrowers acquisition cost. Acquisition cost is defined as the sum of the
11 items:

12 (1) Purchase price shown in the purchase agreement and determined allowable by
13 the lender.

14 (2) The lender's estimate of repair cost, if any, provided such costs are paid by the
15 borrower and are not included in the purchase price.

16 (3) The sum of reasonable financing charges, legal, organizational, and title and
17 recording expenses paid by the borrower.

18 (4) Eligible discounts paid by the borrower at property acquisition.

19 NOTE: Any fees, discounts or other amounts paid by the seller for or on
20 behalf of the purchaser must be reflected as a reduction to the acquisition cost.

21 (6) Eligible architect's fees, mechanical engineering fees, municipal inspection
22 fees, HUD inspection fees, if applicable, and other fees as may be determined
23 eligible by the lender including the cost of lender third party reports.

24 2. Amount of Loan in a Refinancing Transaction:

25 The subject loan will be the lesser of:

26 a. Amounts in Section 8.12.A.1., except e.

27 b. Cost to Refinance. An amount that equals the greater of the following:

28 (1) 80% of the lender's estimate of the value of the project, or

29 (2) The cost to refinance the project, which is defined as the sum of:

30 (a) The amount needed to pay off the existing indebtedness as determined
31 eligible by the lender.

32 (b) The initial deposit to the Reserve for Replacements.

- 1 (c) The sum of reasonable financing charges, legal and organizational, and
2 title and recording expenses paid by the borrower.
3 (d) The lender's estimate of repair cost, if any.
4 (e) Eligible discounts paid by the borrower.
5 (f) Eligible architect's fees, mechanical engineering fees, municipal
6 inspection fees, HUD inspection fees, if applicable, and other fees as may
7 be determined eligible by the lender including the cost of lender third
8 party reports.
9 (g) Less the amount of any: Reserve escrow for replacement and/or major
10 movable equipment that will be purchased as an asset of the project.
- 11 c. Release of Cash-Out / Equity from Loan Proceeds.
12 The maximum loan to value ratio for cash out refinances is 80%. One half (50%)
13 of any cash out proceeds after funding any transaction (mortgageable) costs
14 including the assurance of completion requirements, must be held in escrow by
15 the lender until the non-critical repairs are completed and HUD approves the
16 release. This is true whether or not there are non-critical repairs. See Section 8.13
17 for establishing cash-out/equity requirements.
- 18 B. Identity of Interest Purchase Transaction.
19 Refer to Section 13.16.
- 20 C. Determining Existing Indebtedness in a Refinancing Transaction.
21 Existing indebtedness in a refinancing transaction is defined as:
22 1. Outstanding mortgage(s) incurred in connection with the construction of the project
23 or with capital improvements made to the property as confirmed by the current
24 mortgagee. Use the pay-off letter located in Appendix 8B of this Guide.
25 2. Other recorded indebtedness such as mechanic's liens and tax liens provided they did
26 not result from personal obligations of the borrower.
27 3. Unrecorded debt directly connected with the project supported by documentation
28 from the borrower. If the indebtedness is not recorded, the borrower must provide the
29 lender with documentation, which unquestionably identifies the indebtedness with the
30 project and is not the result of unpaid operational expenses such as delinquent
31 interest, accounts payable or deferred management fee. Examples are:
32 a. Prepayment penalties on the mortgage.
33 b. Indebtedness incurred in making significant betterments to the property.

1 **NOTE:** Program penalties arising from the defeasance of tax-exempt and taxable
2 bonds cannot be recognized. Similarly, the costs of settling prepayment penalties or
3 yield maintenance fees associated with swaps or other derivatives (e.g., swap
4 breakage fees) are not eligible to be included in the calculation of existing
5 indebtedness.

6 4. Mezzanine Debt. Mezzanine debt may only be considered in the eligible basis for
7 refinancing where there is no identity of interest between the principals and the
8 Mezzanine lender or any affiliates of either party, or in cases where the funds were used
9 to fund capital improvements.

10 5. Do not recognize indebtedness:

11 a. Recently placed against the project to increase the mortgage or circumvent
12 program intent. **NOTE:** “Recent indebtedness” for multifamily properties is
13 defined as any debt incurred up to 1 year before the submission of an application
14 for mortgage. Recent Indebtedness can only be recognized if it was used for a
15 non-Identity of Interest acquisition, construction, or for capital improvements to
16 an existing project. Bridge loans to retire maturing debt used for such purposes
17 are acceptable. The borrower must provide sufficient documentation that supports
18 recent indebtedness.

19 b. Created by wrap mortgages

20 (1) The borrower and lender must give a detailed explanation of the purpose of
21 the wrap and a documented accounting of the use and disbursement of the
22 loan proceeds.

23 (2) The lender may recognize loan proceeds used for capital improvements or
24 project operations

25 D. Reserve for Replacements.

26 The cost of an initial deposit to the Reserve for Replacements is eligible for inclusion in
27 the maximum insurable mortgage.

28 1. Purchase Transaction.

29 a. The purchase agreement must specify:

30 (1) Whether or not the transfer includes the Reserve Fund for Replacements or
31 other escrows as an asset of the project.

32 (2) Dollar amounts of escrow and/or items which the seller will pay on behalf of
33 borrower, e.g., the operating deficit, discounts, initial deposit to the Reserve
34 fund for Replacements.

- 1 b. Apply existing Reserve Funds transferred as an asset of the project as a reduction
2 of acquisition cost when computing Criterion 7 on Form HUD 92264-A.
- 3 2. Refinancing Transaction. The borrower must submit a list of escrows currently on
4 deposit for the project:
 - 5 a. The escrow account and minimum Initial Deposit to the Reserve of Replacements
6 must remain with the project.
 - 7 b. Apply funds currently on deposit in a Reserve for Replacements as a reduction of
8 the cost of refinancing under criterion 10 on Form HUD 92264-A.
- 9 E. Discounts and/or Costs of Issuance associated with bond financing may be eligible for
10 inclusion in the computation of Criteria 7 and 10. See Chapter 3 for further details.
- 11

12 **Section 8.12 Firm Commitment Processing with Grants and Loans**

13 A. In General

14 These instructions apply to:

- 15 1. Grants and loans to the borrower entity or its principals from a federal, state or local
16 government agency or instrumentality.
- 17 2. Grants and loans to the borrower entity or its principals from national, regional and
18 local community service organizations (nongovernmental source) or foundations.
- 19 3. Refer to Chapter 14 for guidance on LIHTC, Historic Tax Credit and New Markets
20 Tax Credit equity syndication proceeds.

21 B. Application for Mortgage Insurance.

- 22 1. At the Firm Commitment processing stage, the applicant must:
 - 23 a. Identify the use of grant/loan funds on Form HUD-92013, Application for Project
24 Mortgage Insurance.
 - 25 b. Submit: A commitment letter signed by an authorized agent of the governmental
26 agency or instrumentality or the non-government source identifying:
 - 27 (a) Amount of grant/loan funds including all repayment terms and conditions and
28 any regulatory restrictions that affect the operation of the property.
 - 29 (b) Intended use of the grant/loan funds.
 - 30 (c) Any conditions to the grant/loan and any reasons the commitment letter could
31 be withdrawn.

- 1 (d) That the grant/loan is not subject to a future appropriation or funding
2 availability that it is currently in the hands of and available for disbursement
3 by the governmental agency or instrumentality or the non-government source.
4 2. Any type of grant/loan not disclosed by the borrower may result in a rejected
5 application or the issued Firm Commitment made null and void.

6 C. Grants/Loans from governmental agency or instrumentality.

- 7 1. Firm Commitment. HUD will review the proposed grant/loan structure, terms and
8 conditions and the draft grant/loan documents during Firm Commitment processing
9 or earlier, as needed. HUD will consider waivers with reasonable terms in order to
10 facilitate coordination between FHA requirements and those of the governmental
11 agencies.
12 2. Initial Endorsement
13 a. Before scheduling the closing, the Field Counsel must review the grant/loan
14 documents to assure their legal sufficiency.
15 b. The MAP Lender must consent in writing to the existence of the subordinate
16 mortgage and agree that its existence does not constitute a basis for default on the
17 first mortgage.
18 c. The governmental secondary financing lender must enter into the HUD prescribed
19 form of Subordination Agreement.
20 d. The borrower may use, instead of that portion of the front money escrow provided
21 by the grant/loan, either:
22 (1) An unconditional irrevocable letter of credit issued by a banking institution
23 with a rating acceptable to HUD and for a term acceptable to HUD, or
24 (2) An agreement entered into by HUD, the governmental agency or
25 instrumentality, the MAP Lender and the borrower, which provides the
26 following:
27 (a) HUD has:
28 (i) The right to approve construction advances after considering any
29 reported noncompliance by the agency or instrumentality if the
30 project is proceeding in compliance with approved plans and
31 specifications.
32 (ii) A joint review and agreement between the MAP Lender, HUD and
33 the governmental agency of construction progress schedules and
34 allocation of draws.

1 (iii) Sole authority to resolve differences in the inspection process and
2 the process of disbursing grant/loan proceeds.

3 (b) The MAP Lender will furnish both HUD and the governmental agency
4 with copies of the approved interim advances Form HUD-92448,
5 Contractor's Requisition, Form HUD-92403, Application for Insurance
6 of Advances of Mortgage Proceeds, and supporting documentation

7 (c) The governmental agency or instrumentality must process the advance
8 from its grant or loan funding promptly and without adjustment. HUD or
9 the MAP Lender will:

10 (i) Send the governmental agency a copy of the approved requisition for
11 its records.

12 (ii) The governmental agency must notify HUD and the lender of a need
13 to make an adjustment the following month.

14 (d) The governmental agency assumes the risk for any grant/loan funds
15 disbursed in excess of the amount approved by HUD or the lender and
16 agrees to replenish the excess funds within 10 working days of notification
17 by HUD or the lender.

18 (e) If a default occurs before completion of construction, the governmental
19 agency must disburse the remaining grant/loan funds so long as the
20 request for funds remains in the same ratio as previously authorized.

21 (f) The governmental agency's attorney must render an opinion that the
22 agreement and grant/loan commitment is legally binding on present and
23 all future administrations.

24 e. Grant/loan proceeds must be advanced either:

25 (1) Before the insured mortgage proceeds, or

26 (2) Concurrently and on a pro rata basis with the disbursement of the insured
27 mortgage proceeds.

28 NOTE: If the grant/loan proceeds are not available at initial endorsement,
29 HUD may either:

30 (a) Proceed to initial endorsement, but not disburse any insured mortgage
31 proceeds until the grant/loan is in place and the funds are available for
32 disbursement, or

33 (b) Have the borrower/sponsor fund an escrow equal to the grant/loan.
34 Advances from this escrow must follow outstanding instructions for
35 the disbursement of the grant/loan.

- 1 (3) Release of grant/loan proceeds cannot be conditioned on the completion
2 of specific project improvements.
- 3 3. See Appendix 12A for front money requirements and disbursement of mortgage
4 proceeds on LIHTC projects.
- 5 D. Grants/Loans from a non-governmental source.
- 6 1. Commitment Processing.
- 7 a. The last 3 years of audited financial statements, if available, must be submitted
8 which evidence that the providing source has the financial capacity to meet its
9 funding commitment.
- 10 b. If audited financial statements are not available, unaudited statements, which meet
11 the requirements of Section 8.4.C must be provided.
- 12 2. Initial Endorsement.
- 13 a. Before scheduling the closing, HUD must review the grant/loan documents to
14 assure the legal sufficiency of the documents.
- 15 b. The grant/loan funds must be disbursed before insured mortgage proceeds.
- 16 c. Release of grant/loan proceeds cannot be conditioned on the completion of
17 specific project improvements.
- 18 3. All work performed with the grant/loan proceeds:
19 a. Must be cost certified.
- 20 b. Must conform to Davis-Bacon requirements including submission of payrolls,
21 certifications, etc., if payment of Davis-Bacon wage rates is required by the grant/loan program
22

23 **Se**

24 **ction 8.13 Insurance Upon Completion**

25
26 Insurance Upon Completion (IUC) is an option for new construction and substantial
27 rehabilitation projects financed under Sections 207/223(f), 220, 221(d), and 231. Mortgage
28 insurance is provided after project completion and issuance of Certificates of Occupancy for all
29 units. The following instructions apply to IUC projects:

- 30 A. A financial and credit investigation will be required on the borrower and its principals.
- 31 B. MIP is not included in Form HUD-92264 nor is it charged until the project reaches
32 endorsement

- 1 C. Working Capital and Operating Deficit Escrows. Projects that apply under IUC must
2 meet the operating deficit escrow and working capital requirements as outlined below,
3 except for the extra 2% construction contingency portion of the working capital which is
4 not required.
- 5 D. Assurance of Completion is not applicable to IUC projects. At endorsement, the general
6 contractor must address latent defects by completion of the Latent Defects Escrow, Form
7 HUD-92414M, which requires an escrow of 2½% of the total amount of the Construction
8 Contract in the form of a surety bond, cash escrow or an irrevocable letter of credit issued
9 by a banking institution.
- 10 E. Breakdown of Financing Charges: In IUC projects, before issuance of the Firm
11 Commitment,
12 1. The mortgagee must provide:
13 a. A breakdown of financing charges and discounts by submitting Form HUD-92455M,
14 Request for Endorsement of Credit Instrument, Certificate of Mortgagee, Borrower
15 and General Contractor, with the Certificate of Mortgagee portion completed. The
16 balance of the Form is to be completed before Final Endorsement in lieu of Form
17 HUD-92023M.
18 b. Information relative to the construction and permanent interest rates and mortgage
19 term.
20 2. Each item is reviewed to ensure its reasonableness in relation to comparable projects and
21 market conditions
22 3. HUD will inform the borrower of the fees that are recognizable for cost certification.
- 23 F. Building Loan Agreement, Form HUD-92441M, is not applicable to IUC projects.
24

- 1 used. Construction funded from the contingency portion of the working capital
2 escrow may be considered as the basis for a request for an increased mortgage
3 amount.
- 4 2. Working capital funds are not mortgageable and the unused portion can be released to
5 the borrower. See Chapter 12 Section 12.15 for release of escrow.
- 6 3. For LIHTC projects with a funded working capital reserve held by the partnership
7 (even though controlled by the syndicator or investor and not by HUD or the lender),
8 the funded reserve will be credited towards the increased construction reserve
9 requirement, although the lender controlled account must still meet the 2% working
10 capital escrow requirement.
- 11 4. The working capital escrow requirement for substantial rehabilitation projects is 2%
12 of the mortgage amount
- 13 5. Use Form HUD-92412-M, Escrow Agreement for Working Capital. The lender will
14 deposit said funds in an account insured or guaranteed by a federal agency. See
15 Handbooks 4350.4, Insured Multifamily Mortgagee Servicing and Regional Office
16 Director/PC for the depository requirements.
- 17 F. Operating deficit escrow.
- 18 1. For all new construction, and substantial rehabilitation projects in which there will be
19 significant resident displacement resulting in negative cash flow during the
20 rehabilitation period, the operating deficit escrow will be the greater of:
 - 21 a. What the appraisal and underwriting analysis determines to be appropriate, or
 - 22 b. 3% of the mortgage amount, or
 - 23 c. 4 months debt service (Principal & Interest and Mortgage Insurance Premium) if
24 the property is a garden apartment, or 6 months debt service (Principal & Interest
25 and Mortgage Insurance Premium) if the property is an elevator building where a
26 single Certificate of Occupancy will be issued before any of the units or any of
27 the entire floors can be rented.
- 28 2. HUD will consider lender requests for operating deficit escrow draws during lease-up
29 based on the adequacy of the remaining amount of operating deficit escrow on

- 1 deposit with the project. See Chapter 12 Section 12.15.E for further mitigation and
2 release guidance.
- 3 3. The amount of the operating deficit escrow for substantial rehabilitation projects with
4 at least 90% project based rental assistance shall only be based upon the conclusions
5 of the appraisal and underwriting analysis and need not be the higher of 3% of the
6 mortgage amount or 4 months of debt service. The underwriting presentation should
7 provide a detailed estimate of the projected cash flow through the period of the
8 rehabilitation to support the lower escrow amount.
- 9 4. For LIHTC projects with a funded operating deficit reserve held by the partnership
10 (even if controlled by the investor and not by HUD or the lender), the funded reserve
11 will be credited towards the increased reserve requirements of 3% of the mortgage
12 amount or 4 months of debt service, although the lender controlled account must still
13 meet what the appraisal and underwriting analysis determines to be an appropriate
14 operating deficit amount.
- 15 5. Use Form HUD-92489a-M, Escrow Agreement for Operating Deficit. The lender
16 will deposit said funds in an account insured or guaranteed by a federal agency. See
17 Handbook 4350.4, Insured Multifamily Mortgagee Servicing and Regional/Satellite
18 Office for the depository requirements.
- 19 G. Commitment, marketing fees, and discounts must be paid out-of-pocket by the
20 sponsor/borrower and may not be paid from the operating deficit escrow.
- 21 H. For tax-exempt or taxable bond financing, cost of issuance must be paid out-of-pocket by
22 the sponsor/borrower and may not be paid from the operating deficit escrow.
- 23 I. Relocation payments not included in lender's estimated replacement cost on Form HUD-
24 92264-A may be paid from the operating deficit escrow.
- 25 J. The lender must deduct from the estimated replacement cost the maximum insurable
26 mortgage, any grant/ loan funds or tax credit equity attributable to replacement cost items and
27 fees not to be paid in cash. The remainder is the estimated financial requirements needed to
28 complete the project. These calculations should be recorded on Form HUD-92264-A
- 29 K. Cash-Out Escrow from Land Equity.

1 If land, or the “as is” property value for a substantial rehabilitation project, is contributed
2 to meet the sponsor’s equity requirement, any cash-out from the excess land or property
3 equity **above** what is required at initial endorsement must be deferred until the project is
4 complete and it has demonstrated to the satisfaction of the Regional Office that
5 operations of the project have achieved 6 consecutive months of break-even occupancy or
6 12 months break-even occupancy for transactions meeting Large Loan parameters. At
7 initial endorsement the lender will establish an escrow and the balance thereof can be
8 released to the borrower after the deferral period. This does not prevent the borrower from
9 applying land value equity to fund the operating deficit or working capital escrows, or
10 other cash requirements at initial endorsement. To the extent that there are excess
11 mortgage proceeds available from the land value (or “as is value”) or other equity, and
12 after capitalizing the required escrows etc., any remaining balance of excess mortgage
13 proceeds may also be used for all the purposes described in Appendix 12A, paragraph D.
14 This includes funding the working capital construction contingency escrow. See Chapter
15 12 Section 12.8 and 12.15 for guidance. After all escrows and cash requirements are
16 established at initial endorsement any balance remaining in the land escrow is deferred until
17 operations of the project have achieved 6 consecutive months of break-even occupancy.
18 After this period the balance of the escrow can be released to the borrower. (See Section
19 12.15.F for details.)

20 L. Cash-Out / Equity from Loan Proceeds – Section 223(f).

21 Critical repairs must be completed before initial/final closing. Fifty percent (50%)
22 of any cash out proceeds after funding any transaction costs including the
23 assurance of completion requirements, must be held in escrow by the lender until
24 the non-critical repairs are completed and HUD approves the release. The escrow
25 is established at Initial/Final Endorsement, on Form HUD-92476.1M, Escrow
26 Agreement for Non-Critical, Deferred Repairs.

27 M. Tax Credit Equity Contribution –

- 28 1. HUD requires that an appropriate amount of the equity be invested in the project and
29 applied to HUD approved costs at the time of Initial Endorsement. The amount
30 deemed by HUD to be sufficient for such purposes will depend on the circumstances
31 of each transaction, but should be an amount that assures an ongoing relationship
32 between the borrower and the tax credit syndicator or investor.

33 It is recommended that the initial installment of equity be an amount that is equal to
34 or exceeds 20% of the total equity that will be available for the project. HUD has

1 adopted a fixed pay-in schedule for all LIHTC transactions, and therefore waivers of
2 the first 20% equity pay-in will not be considered (please refer to Chapter 14 of the
3 MAP guide). An example of Form HUD-92264-A to assist with the calculation of the
4 amount of the initial and subsequent infusions of tax credit equity follows.

5 2. The initial installment of equity must be expended on the initial requisition at Initial
6 Endorsement.

7 3. Example for Form HUD-92264-A.

8 There is no change in the computation to determine the cash requirements and/or
9 front money escrow on Form HUD-92264-A. The initial installment of LIHTC
10 equity is calculated as follows

11
12 **Form HUD-92264-A Section II. Total Requirements for Settlement – Part B**

13	1. a. Development Cost	<u>\$14,381,216</u>
14	1. b – c Total of lines a & b	<u>\$14,381,216</u>
15	2. Land Indebtedness (or cash required for acquisition)	<u>\$ 625,000</u>
16	3. Subtotal (lines 1c + 2)	<u>\$15,006,216</u>
17	4. a. Mortgage Amount	<u>\$10,935,000</u>
18	4. b. Home funds	<u>\$ 650,000</u>
19	5. Fees not to be paid in cash	<u>\$ 0</u>
20	6. Subtotal (lines 4a+4b+5)	<u>\$ 11,585,000</u>
21	7. Cash investment required (line 3 minus line 6)	<u>\$ 3,421,216</u>
22	8. Initial Operating Deficit	<u>\$ 488,772</u>
23	9. Other Cost (Bond cost \$312,617) and \$15,000	<u>\$ 327,617</u>
24	10. Working Capital	<u>\$ 218,700</u>
25	11. Other: Social Services Escrow \$55,000 + Fee \$2,066,897)	<u>\$ 2,121,897</u>
26	12. Total estimated cash requirement (sum of lines 7+8+9+10+11)	<u>\$ 6,578,202</u>
27	Front money escrow, if any (subtract line 6 from line 1)	<u>\$ 2,796,216</u>

28 **Section III. Source of Funds to Meet Cash Requirements**

29	Source A Tax Credit Equity	<u>\$5,027,301</u>
30	Source B Developer Funds	<u>\$1,550,901</u>
31	Total available cash for project.....	<u>\$6,578,202</u>

32
33 The initial 20% calculation of the tax credit equity (which *should be the same as the*
34 *tax credit equity amount reflected in Criterion 11*) for mortgageable items is

1 \$1,005,460. This is based upon the mortgageable tax credit allocation of \$5,027,301
2 x 20% = \$1,005,460; it is not based on the total cash requirements for the project.
3 The remaining cash requirements **not** being satisfied with LIHTC equity will be
4 satisfied in accordance with outstanding instructions. The borrower must pay out-of-
5 pocket when there are zero available cash computed on Form HUD-92283.

6 4 Subsequent Investment of Tax Credit Equity Proceeds

7 a. The *Commitment for Insurance of Advances*, Form HUD-92432, should contain,
8 among other special conditions, a requirement for evidence satisfactory to HUD
9 of an agreement that binds the investor to timely and periodically pay to the
10 borrower tax credit equity to contribute to the completion costs, in the aggregate
11 amounts shown on Forms HUD-2880 and HUD-92013. To that end, HUD
12 requires that no less than an additional 30% of total tax credit equity be
13 contributed no later than 65% of project completion, with an additional
14 contribution of 45% of equity paid in at project stabilization, regardless of
15 whether the project is a new construction or refinance. See the special conditions
16 in Appendix 4D.

17 b. The actual amount of the initial equity investment should be reflected in the Firm
18 Commitment as a special condition and listed as a line item on the initial
19 requisition, HUD Form HUD-92403, Application for Insurance of Advance of
20 Mortgage Proceeds, for immediate disbursement.

Section 8.15 Bond Financed Projects

A. Review of Financing Documents. A tax-exempt bond is a security issued by a governmental agency in which the interest income produced is free from federal income tax and sometimes free from state and/or local income tax. Financing documents associated with mortgage bonds or tax-exempt bonds are prepared and reviewed by the bond underwriter and the bonds are secured by a mortgage on one or more assets. In FHA insured transactions, these bonds are backed indirectly by an interest in the insured loan which is further enhanced by a GNMA Security.

1. The sponsor must submit, with the application for commitment processing, a separate statement itemizing the estimated costs of bond issuance, issuer fees and discounts and financing fees to be paid out of pocket by the sponsor/borrower with an explanation of the necessity and reasonableness of each cost. The lender's underwriter must check the statement for reasonableness, using the data from previously processed bond-financed projects and make adjustments where appropriate. This information is used to develop the Total Estimated Cash Requirement Form HUD-92264-A, Supplement to Project Analysis.

B. Loan Rates.

1. The construction loan and the permanent loan rates may exceed the interest rate on the bond obligations. When this occurs, the spread will create a surplus of funds which must be held by the bond trustee. At initial closing, the bond counsel must supply HUD with a legal opinion stating that any investment income received by the mortgagee but not held for its own account must be under the control of the bond trustee and will not flow through the books and records of the project. The bond documents will instruct the trustee to invest the funds in a federally insured interest bearing account, submit the project's financial statement, or the borrower may use the surplus of funds to cover costs associated with the bond financing transaction.
2. In many cases, the interest rate on the bonds will not be known during the commitment processing and it is not uncommon for the rate to change once the bonds have been sold and the bond interest rate has been established. If the mortgage rate changes, an amendment letter to the Firm Commitment should be issued reflecting the actual interest rate. If, due to time constraints, HUD does not have sufficient time

1 to reprocess a higher mortgage for the project, the Firm Commitment must contain
2 the following condition:

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

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

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

12 (2) Subtracting the actual interest cost recognized at cost certification from the
13 revised interest figure developed in (1) above.

14 3. HUD will allow a total financing and placement fee of 5.5% on bond financed
15 applications. This limit applies to all multifamily Sections of the Act except Section
16 223(a)(7) and is reflected in the replacement cost mortgage amount confirmed at cost
17 certification.

18 C. Bonds may be sold at a premium to investors, whereby the investor pays an amount in
19 excess of the face value of the bonds. The premium results from the bonds carrying a
20 higher coupon rate than is generally available in the marketplace.

21 1. Any premium raised by a transaction is considered part of the mortgagee, bond
22 underwriter, or issuer’s profit. However, if a mortgagee gives something of value
23 without the expectation of being repaid, HUD considers this to be a kickback. The
24 one exception involves tax-exempt bond transactions where the issuer of the bonds
25 may permit the borrower to receive some portion of the premium to offset the cost of
26 issuance so that the mortgagee, bond underwriter and issuer are simply conduits for
27 the transfer of funds.

28 2. If any of the premium is returned to the borrower, it will be considered excess
29 investment income and treated as project income and used to reduce the total
30 allowable cost of the project.

- 1 3. On bond financed projects, the premiums may be treated as project income under the
2 following conditions:
 - 3 a. The sponsor/borrower entity cannot benefit monetarily from the excess
4 investment income.
 - 5 b. The premium, if accessible to or given to the sponsor or borrower entity it
6 controls, is considered as excess investment income.
 - 7 c. Closing documents must detail the amount of the premium being given to the
8 sponsor or the borrower entity it controls.
 - 9 e. The premium may be used to pay for additional cost associated with the cost of
10 issuance and may be applied to other recognizable cost overruns.
 - 11 f. The borrower's accountant for an audited cost certification, or the borrower for
12 an unaudited cost certification, must detail in the notes to the financial statement
13 the amount of excess income received.
- 14 4. For nonprofit applications, excess income generated from premiums may be applied
15 to recognizable cost overruns. Any excess income over and above that used towards
16 recognizable cost overruns must be transferred to the reserve for replacement account.
- 17 5. On Section 223(f) applications, excess income generated from premiums must be
18 transferred to the reserve for replacement account.
- 19 D. Itemized Statement of Costs. An itemized statement of the costs of issuance of the
20 obligations, discounts and financing fees paid through the mortgagee must be attached to
21 and reflected in the Lender's Certificate, Form HUD-92434M,
 - 22 1. The statement must explain why each individual item is necessary for the issuance of
23 the obligations.
 - 24 2. The lender must review the amount of each item to ensure its reasonableness in
25 relation to comparable projects.
 - 26 3. A letter from the Regional Office Director will inform the mortgagee that HUD will
27 recognize for cost certification purposes the costs of issuance, discounts and financing
28 fees in an aggregate amount not to exceed 5.5% included in the mortgage for all
29 programs (except Section 223(a)(7)).

- 1 4. The mortgagee, bond underwriter, and issuer have the option of deferring collection
2 of additional discounts, financing fees slow draw fees, etc., through the provision of
3 Paragraph 20(G) of the Lender's Certificate (Form HUD-92434M).
 - 4 a. The deferred collection of these items must be an obligation of a third party. Both
5 the third party and the mortgagee bond underwriter or issuer must attest in writing
6 that they will not look for payment from the:
 - 7 (1) Borrower;
 - 8 (2) Mortgaged property;
 - 9 (3) Mortgage proceeds;
 - 10 (4) Any reserve or deposit required by HUD and/or the mortgagee in connection
11 with the insured mortgage transaction; or
 - 12 (5) Rents or other income from the mortgaged property.
 - 13 b. The borrower entity may issue, as evidence of the debt, surplus cash or residual
14 receipts note to the third party for costs identified in this paragraph which HUD
15 determines to be reasonable.

16 E. State and Local Bond Financed Projects.

- 17 1. Prepayment of Note. See special rules for State and local bond financed projects
18 pertaining to prepayment restrictions and penalty charges in Chapter 11 Section
19 11.6.B.3.
- 20 2. State/Local Occupancy, Use and/or Rent Restrictions. Use or rent restrictions sought
21 by the State or local jurisdiction for projects financed by proceeds from State/local
22 tax-exempt obligations are often more restrictive than the minimum requirements of
23 the Internal Revenue Code. The Regional/Satellite Office Director may approve a
24 State or local restriction exceeding the minimum requirements of the Internal
25 Revenue Code, but only if the following conditions are met:
 - 26 a. The Regional/Satellite Office Director must determine that the restriction is not
27 likely to have an adverse impact on project occupancy, marketability or long-term
28 feasibility. This determination must be made on a project-by-project basis.
 - 29 b. The restriction must not conflict with any applicable HUD mortgage insurance
30 regulations or related administrative requirements.

- 1 c. The restriction must not appear in the Note, Mortgage, Regulatory Agreement or
2 any other HUD/FHA loan document.
- 3 d. The restriction must be qualified to provide that it will automatically terminate in
4 the event of either foreclosure or transfer of title by deed in lieu of foreclosure.
5 Such a termination provision must be included in every legal instrument (e.g.,
6 deed, land use restriction agreement, Security Agreement, or financing
7 agreement) in which the restriction appears.
- 8 F. Pre-Cost Certification Conference Information. The lender must demonstrate at the pre-
9 cost certification conference that:
- 10 1. The net cost of negative arbitrage (i.e.: the escrow account yield vs. capitalized
11 interest expense) may be recognized if there are offsetting savings in the mortgage.
- 12 2. Any rebate to the sponsor/borrower from the mortgagee, issuer or bond underwriter
13 will reduce the mortgage at cost certification. The following are two samples of the
14 most common types of rebates.
- 15 a. If mortgagee/bond underwriter contributes a portion of the initial service charge
16 that was collected to pay discounts or other fees.
- 17 b. If mortgagee/bond underwriter refunds a portion of the construction loan interest
18 to the borrower or sponsor.

Chapter 9 Environmental Review and Requirements

9.1 Introduction

This chapter outlines for the lender and HUD staff the policies and procedures that the HUD staff must follow to meet environmental responsibilities. The lender is required to make certain application submissions, and must submit any additional or updated environmental information prior to submission of the Firm Commitment deliverables. The team leader can direct the staff to complete the HUD environmental assessment prior to submission of the Firm Commitment deliverables in order to expedite the review, but should do so only where it is clear that the lender will meet the deadline for submission of the Firm Commitment deliverables.

A. Legal Authorities, Handbooks, and Forms

1. All Federal agencies are required to comply with the National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.) (NEPA), and the implementing procedures issued by the Council on Environmental Quality at 40 CFR Parts 1500-1508. HUD regulations implementing NEPA are contained in 24 CFR, Part 50, "Protection and Enhancement of Environmental Quality". Related Federal laws and authorities are listed in 24 CFR 50.4 and 50.3(i). HUD may not delegate its environmental responsibilities to others; it is required to prepare the environmental assessment and make the appropriate environmental finding. (See 24 CFR 50.11.)
2. HUD has issued two handbooks covering environmental issues: Handbook 1390.2, "Environmental Assessment Guide for Housing Projects", and Handbook 1390.4 "Guide to HUD Environmental Criteria and Standards contained in 24 CFR 51". Informal guidebooks issued by HUD on environmental issues are cited in this chapter. In addition, HUD offices may make the Guide, "Choosing an Environmentally Safe Site", which is used in the Section 202 and 811 programs, available to all projects.
3. HUD has established environmental Form HUD-4128, "Environmental Assessment and Compliance Finding for Related Laws", to document compliance with NEPA and other environmental Federal laws, authorities, Executive Orders, and HUD standards. Form HUD-4128, with attached Sample Field Notes Checklist (SFNC), may be

- 1 retrieved electronically from HUDClips. The use of Form HUD-4128 to document
2 environmental assessments and reviews by HUD staff is required by 24 CFR 50.31.
3 It is important to note that the Phase I Environmental Site Assessment (ESA) must be
4 cited as source documentation in Part A, Item 23, of the HUD-4128, Toxic Chemicals
5 and Radioactive Materials (24 CFR 50.3(i). HUD staff will use the SFNC to provide
6 information supporting the conclusions listed on Form HUD-4128.
- 7 4. Existing apartment projects to be refinanced or purchased under Section 223(f) are
8 categorically excluded (CE) from NEPA compliance (Part B of Form HUD-4128)
9 (see 24 CFR 50.20(a)), except in extraordinary circumstances (see 24 CFR 50.20(a)
10 and (b)), but they must comply with the laws and authorities listed at 24 CFR 50.4
11 (Part A requirements of Form HUD-4128). CE projects must also comply with the
12 Contamination Analysis requirements discussed at 9.3 (as required by 24 CFR
13 50.3(i)), and with the Lead, Asbestos and Radon Report requirements discussed at
14 9.5.A, B, and C. Many substantial rehabilitation projects will also qualify for a CE
15 from NEPA compliance. Part B Line 28 of Form HUD-4128 must be used to
16 document compliance with the parameters related to Nuisances and Hazards at 9.5.O,
17 such as pipelines, fall hazards, and oil gas wells, even for CE projects.
- 18 5. Pursuant to 24 CFR 50.19(b)(21), “refinancing of HUD-insured mortgages that will
19 not allow new construction or rehabilitation, nor result in any physical impacts or
20 changes except for routine maintenance” is categorically excluded from the
21 environmental assessment (EA) requirements of the National Environmental Policy
22 Act (NEPA), except in extraordinary circumstances, and does not require compliance
23 with the Federal laws and authorities specified at 24 CFR Part 50.4, other than for the
24 flood insurance requirements specified at 24 CFR 50.4(b)(1). Thus, currently HUD-
25 insured Section 223(f) and 223(a)(7) refinancing transactions that meet these criteria
26 do not require an environmental review. However, the flood insurance requirements
27 specified at 24 CFR 50.4(b)(1) are still applicable.
- 28 6. Requirements in this chapter may exceed those of many State agencies. One reason
29 for this is if a mortgagor defaults on an FHA-insured project, HUD may become the
30 project owner. Under Section 120(h) of the Comprehensive Environmental Response
31 and Liability Act (CERCLA), Federal agencies that own properties are required to
32 take “all remedial action necessary to protect human health and the environment”
33 with respect to known hazardous substances upon disposition of the property. This
34 requirement is beyond any liability releases under State or Federal law and any due
35 diligence requirements under CERCLA.
- 36 B. Local, State, Tribal or Federal Laws
- 37 1. The acronym LSTF as used in this chapter refers to “local, state, tribal or Federal”.

1 submission, or other informal, preliminary discussions, meetings, or
2 correspondence with HUD or with a lender for the purpose of preparing an
3 application for FHA multifamily mortgage insurance. Specifically, no action
4 concerning the proposal shall be taken which would: (1) have an adverse
5 environmental impact; (2) limit the choice of reasonable alternatives, or (3)
6 prejudice the ultimate decision on the proposal.

7 a. Certain actions do not fall within such limitations, such as development of
8 plans or designs, or performance of other work necessary to support an
9 application for Federal, State or local permits.

10 b. Other actions do fall within such limitations, such as acquisition, demolition,
11 modification of a wetland, or actions that significantly adversely affect a
12 historic property. Additionally, pursuant to the “anticipatory demolition”
13 requirements of Section 110(k) of the National Historic Preservation Act (54
14 U.S.C. 306113), even before application submission takes place, any action by
15 a potential lender or borrower, or any action by another party that the lender
16 or borrower has the legal power to prevent, that is taken with the intent to
17 avoid Section 106 review and that significantly adversely affects a historic
18 property, could result in rejection of an application.

19 c. If any party is unsure as to whether an action would fall within such
20 limitations it should seek advice and possibly approval by HUD. These
21 requirements are distinct and separate from any early start of contractually
22 related construction activities as discussed in Chapter 13.

23 7. Lenders are required to submit all the exhibits necessary to resolve any
24 environmental issues with the Firm application submission. For lenders that use the
25 pre-application process for new construction or substantial rehabilitation proposals,
26 HUD requires the various reports be submitted at pre-application, unless otherwise
27 indicated. The purpose of asking for certain documents at the pre-application stage
28 is to help make an early evaluation of any environmental issues to be resolved, so
29 that HUD can determine if all environmental issues can be resolved at the Firm
30 Commitment processing stage. The letter of invitation will condition the issuance
31 of a Firm Commitment upon a finding on the Form HUD-4128 that there are no
32 unresolved environmental concerns.

33 8. Any identified environmental issues will require a discussion of impacts to human

1 health and appropriate mitigation measures. The lender must provide mitigation
2 plans for those environmental problems when the application is submitted.
3 Remediation of site contamination is discussed in Section 9.3 of this chapter, and
4 requires that LSTF approval of those plans be submitted with the application for
5 Firm Commitment. The implementation of mitigation and remediation plans may,
6 with HUD approval, continue throughout the construction period. HUD will review
7 the lender's plan and make it a condition of the Firm Commitment if HUD
8 considers the plan acceptable. This would include any plans for remediation of site
9 contamination, wetlands impacts, noise impacts, radon, historic preservation, and/or
10 floodplain management issues.

- 11 9. Removal or containment of lead-based paint or asbestos may continue beyond
12 Initial and Final Endorsement if HUD approves.

13 B. HUD Staff Responsibility

- 14 1. In accordance with 24 CFR 50.32, HUD, not the lender, is responsible for
15 independently evaluating the information supplied by the lender, supplementing
16 that information as needed, making the required findings and preparing the Form
17 HUD-4128 and supporting documentation to the environmental record for the
18 project. HUD will determine whether the project raises environmental conditions
19 that are prohibited by law, Executive Order, or regulation, or which would endanger
20 health or safety, or would put FHA mortgage insurance or the U.S. Government at
21 financial risk or liability.
- 22 2. HUD staff shall promptly notify the lender that it will take appropriate action to
23 insure that the objectives and procedures of HUD environmental policy are
24 achieved if it becomes aware that an action subject to limitation as discussed in
25 Section 9.2.A.6 has taken place or may be about to take place.
- 26 3. HUD staff must review the documentation submitted by the lender and trained
27 technical or underwriting staff must make a site visit. The site visit will help
28 validate the information provided on the Phase I ESA and is useful for evaluating
29 other environmental factors. The HUD reviewer will sign the completed Form
30 HUD-4128 as the preparer, and the form will be co-signed by the Regional Center
31 Regional Office Director, who issues the commitment.
- 32 4. Regulation 24 CFR 50.32 requires that a NEPA Environmental Assessment for a
33 project with more than 200 apartment units be sent for review and comment to the

1 appropriate Regional or Field Environmental Officer (REO/FEO). The REO/FEO
2 must also be given the opportunity to review and comment on any Form HUD-4128
3 in which the project is in the normally unacceptable or unacceptable noise zone.
4 Categorically excluded projects, as discussed at Section 9.1.A.4, do not require
5 review and comment from the REO/FEO. However, it is recommended that
6 REO/FEOs be given the option to review and comment when special analysis is
7 required under the laws and authorities listed at 24 CFR 50.4 or the project involves
8 potentially significant environmental concerns. REO/FEOs should be contacted for
9 input early on during consideration of an application, including at Concept Meeting.

- 10 5. Completed environmental records must be available for the REO/FEO to review.
11 Up to ten percent (10%) of files may be reviewed in any given year.
- 12 6. As part of its environmental review responsibilities, HUD may require additional
13 environmental material from a lender, such as a Phase II ESA or a Biological
14 Evaluation, even when the lender might not believe that such additional
15 environmental material is necessary.
- 16 7. HUD will discuss any environmental conditions in the letter of invitation for
17 Sections 221(d)(3) and (d)(4), 220, and 231. Any requirements that affect project
18 design will be fully detailed. The lender must assure that any requirements
19 affecting project design are conveyed to the design architect for incorporation into
20 the contract drawings and specifications.
- 21 6. The Regional Center Regional Office shall ensure that all environmental conditions
22 are resolved and the Form-4128 is completed and approved prior to issuance of a
23 Firm Commitment.
- 24 7. HUD staff should refer to the specific directions and guidance contained in Section
25 9.4 for projects that involve remediation and or monitoring.

26 C. Qualifications of Professionals

- 27 1. The sponsor/developer will generally select the professionals who prepare the
28 Environmental Report, the Phase I ESA, or any other environmental information
29 required by HUD, but the lender must verify that the professionals used are
30 qualified for their assigned responsibilities. It is recommended that the
31 professionals have prior HUD experience.

- 1 1. Submission. The lender must submit a complete and final Phase I ESA with the
2 pre-application or, if the pre-application stage is omitted, with the application for
3 Firm Commitment. A summary submission is not acceptable. The lender must
4 inform the ESA preparer of all of the following Phase I ESA requirements:
 - 5 a. Purpose. The Phase I ESA will make an initial determination as to the presence
6 of “hazardous substances” as defined by CERCLA, and of petroleum and
7 petroleum products. However, HUD requires an initial determination not for
8 CERCLA purposes, but rather as a part of the Department’s overall
9 environmental responsibilities pursuant to 24 CFR 50.3(i), which states HUD’s
10 policy that all properties proposed for use in HUD programs be free of
11 hazardous materials, contamination, toxic chemicals and gases, and radioactive
12 substances, where a hazard could affect the health and safety of occupants or
13 conflict with the intended utilization of the property. This purpose must be
14 described in the “Purpose” subsection to the required “Introduction” Section of
15 the Phase I ESA.
 - 16 b. Format. The Phase I ESA must be prepared in accordance with the
17 requirements of ASTM E1527-13 “Standard Practice for Environmental Site
18 Assessments, Phase I Environmental Site Assessment Process” (or most recent
19 edition). The Phase I ESA must utilize the table of contents and report format
20 specified in Appendix X4 of ASTM E 1527-05. The Phase I ESA must
21 incorporate a vapor encroachment screen performed in accordance with ASTM
22 E 2600-10 (or most recent edition). The Phase I must clearly indicate that HUD
23 is an authorized user of the report.
 - 24 c. Timing. The Phase I ESA must be conducted (meaning the earliest of the date
25 of the site visit, records review documents, or interviews) within one-year of the
26 submission to HUD. A Phase I ESA that was conducted more than 180 days
27 prior to the submission date to HUD, but within the allowable one-year period,
28 must be updated pursuant to Section 4.6 of ASTM E 1527-13 (or similar section
29 of the most recent edition). A Phase I ESA prepared more than one year prior to
30 submission to HUD, even if updated within 180 days of being submitted, is not
31 acceptable.
 - 32 d. Preparer’s Qualifications. The Qualifications section of the Phase I ESA must
33 describe the preparer’s qualifications. The Environmental Professional
34 preparing the Phase I ESA must meet all of the qualification requirements of

- 1 Appendix X2 of ASTM E 1527-13 (or similar section of the most recent
2 edition) and must meet the license/certification, education and experience
3 requirements of Section X.2.1.1(2)(i), (ii) or (iii) of Appendix X2 of ASTM E
4 1527-13 (or similar section of the most recent edition).
- 5 e. Findings Section. The Findings section of the Phase I ESA must list all known
6 or suspect Recognized Environmental Conditions (REC), Controlled
7 Recognized Environmental Conditions (CREC), Historical Recognized
8 Environmental Conditions (HREC) and de minimis conditions (such as minor
9 soil staining). The Findings section must also list Vapor Encroachment
10 Conditions (VECs), likely VECs, and circumstances in which VECs cannot be
11 ruled out.
- 12 f. Opinions Section. The Opinions Section must discuss each finding from the
13 Findings section and whether it is a REC pursuant to Section 12.6 of ASTM E
14 1527-13 (or similar section of the most recent edition). The justification for any
15 Finding deemed not to be a REC must be included in the Opinions section. If
16 the ESA preparer cannot make a statement as to whether a condition is or is not
17 a REC, the Opinion Section must state what information or further investigation
18 would be deemed necessary to make such a determination. The ESA preparer
19 must also identify any data gaps. When previous remediation has been
20 performed or is ongoing, i.e., not yet an HREC at the proposed site, the Phase I
21 ESA must fully discuss the extent of such remediation in this section of the
22 Phase I ESA, including any involvement of LSTF Authorities. The Phase I
23 preparer must justify whether such ongoing remediation should resolve any
24 RECs or undecided issues identified in the ESA. Note that even if the
25 Environmental Professional preparing the Phase I ESA determines that a
26 Finding does not rise to the level of a REC, HUD may determine that the
27 finding is a business environmental risk that warrants Phase II investigation.
- 28 g. Conclusions Section. The Conclusions Section must make a determination of
29 whether a REC, including a CREC, exists on the site in accordance with one of
30 the two quoted statements at Section 12.8 of ASTM E 1527-13 (or similar
31 section of the most recent edition).
- 32 h. User Provided Information Section. The borrower, or the current property
33 owner (if different from the borrower), shall complete the User Questionnaire(s)
34 as per Appendix X3 of ASTM E-1527-13 (or similar section of the most recent

1 edition) which must be included in the “User Provided Information Section” of
2 the Phase I ESA and the preparer must take into account any information
3 provided in the preparation of the Phase I ESA.

- 4 i. Testing Not Required. The Phase I ESA does not require sampling and testing
5 which will be performed during the course of a Phase II ESA or as part of a
6 remediation plan (see below). However it may reference and discuss a prior
7 Phase II ESA performed in general accordance with ASTM E 1903-11 (or most
8 recent edition) including whether a condition is a REC.
- 9 j. Vapor Encroachment Screen. The Phase I ESA must incorporate an initial
10 vapor (a.k.a. gas) encroachment screen to determine if there is a potential for
11 vapors to occur in the subsurface below existing and/or proposed on-site
12 structures. Those hazardous substances may be petroleum and petroleum
13 products that consist of volatile organic compounds (VOC), semi-volatile
14 organic compounds (SVOC) and inorganic volatile compounds. The initial
15 vapor encroachment screen shall be performed using Tier 1 “non-invasive”
16 screening pursuant to ASTM E 2600 - 10 “Standard Guide for Vapor
17 Encroachment Screening on Property Involved in Real Estate Transactions,
18 Section 8” (or most recent edition). If the Tier 1 vapor encroachment screen
19 determines that, as indicated in ASTM E 2600-10, Section 8.7.1 (or similar
20 section of the most recent edition), there is a “vapor encroachment condition”
21 (VEC) which is the “presence or likely presence” of such vapors in the
22 subsurface below existing and/or proposed on-site structures, a likely VEC, or
23 that a VEC “cannot be ruled out”, it must be deemed to be a REC for purposes
24 of the Phase I ESA. Analyses regarding the VES must be integrated within the
25 body of the various sections of the Phase I ESA.
- 26 k. Lead-based Paint (LBP) Chips. LBP chips that are not inside or part of a
27 structure may be deemed to be a hazardous substance under CERCLA (see EPA
28 document referenced at Section 9.3.C.1.c.iv, below). Therefore, if there is or
29 was a structure on the site that was built prior to 1978, any evidence of paint
30 chips not inside or part of any current structures must be discussed in the “Site
31 Reconnaissance” section of the Phase I ESA, must be listed in the Findings
32 Section, and must be discussed further as to whether the paint chips are either a
33 REC or a de minimis condition in the Opinions section.

- 1 l. Previous Remediation. When previous remediation has been performed, or
2 remediation is currently taking place, the Phase I ESA must fully document
3 such remediation, including any involvement from LSTF Authorities.
- 4 m. Evaluation of the ESA. The Phase I ESA will be evaluated by HUD to
5 determine if the property is acceptable for the hazards reviewed. HUD may
6 require additional information or a Phase II based on findings that indicate an
7 unacceptable business environmental risk. Any Phase I ESA that identifies a
8 REC will require a Phase II ESA, unless it can be determined from the Phase I
9 ESA that corrective action is not feasible. If no corrective action is feasible,
10 HUD may reject the property.

11 B. Phase II ESA

- 12 1. Purpose. The purpose of the Phase II ESA is to ascertain within the requirements of
13 ASTM E 1903-11, “Environmental Site Assessments: Phase II Environmental Site
14 Assessment Process” (or most recent edition), whether the RECs identified in the
15 Phase I ESA have resulted in the presence of “hazardous substances” as defined by
16 CERCLA, and/or of petroleum and petroleum products at levels that would exceed
17 LSTF unrestricted criteria (de minimis levels).
- 18 2. Timing. The Phase II ESA shall be submitted with the pre-application or, if the pre-
19 application stage is omitted, with the application for Firm Commitment. It is
20 recommended that lenders consult with HUD before a Phase II ESA is prepared.
- 21 3. When Required. A Phase II ESA is required if:
 - 22 a. The Phase I ESA indicates that there is a REC; or
 - 23 b. HUD requires a Phase II ESA for reasons that are described to the lender.
- 24 4. Exception to Submission Requirement. In some cases wherein it is obvious that
25 remediation will be required, with HUD permission a separate Phase II ESA may be
26 bypassed and instead incorporated within the “site characterization” segment of the
27 remediation plan referenced in Section 9.3.C.1 below.
- 28 5. Standards to Use. The Phase II ESA is to be performed pursuant to the logic model
29 of ASTM E 1903-11, Section 7 (or similar section of the most recent edition),
30 including developing the conceptual model and validation.
- 31 6. Report Format. The Phase II ESA must be prepared in accordance with the
32 requirements of ASTM E 1903-11 using the table of contents and report format

1 specified in Appendix X3.2 as amended by X3.3 (or similar section of the most recent
2 edition). Some of the steps that a Phase II assessor might perform may be intuitive in
3 nature, but they nevertheless must be included in the report so as to ensure its
4 scientific validity.

- 5 7. New Construction or Substantial Rehabilitation Projects using Pre-application. For
6 new construction or substantial rehabilitation projects with a pre-application, the
7 Phase II ESA, if required, shall be submitted by the lender with the pre-application
8 and must be reviewed by HUD before an invitation letter is issued.
- 9 8. HREC. If the Phase I ESA indicates that there is a HREC, as described in ASTM E
10 1527-13 (or most recent edition), i.e., a hazard has been remedied and an LSTF
11 Authority has issued a No Further Action (NFA) letter or similar approval, HUD may
12 either deem the NFA as completion of the remediation or it may require a Phase II
13 ESA and/or further remediation.
- 14 9. Natural and Extent of the Study. The Phase II ESA need not necessarily be a
15 complete site characterization (total nature and distribution) of contamination, but
16 must proceed to a point where it indicates the location of greatest concentration and
17 risk. However, when the existence of elevated levels of contaminants is confirmed, a
18 complete site characterization will be required as a first step in remediation per
19 Section 9.3.C.1 below.
- 20 10. Vapor Encroachment/Vapor Intrusion. If it is determined that there is a potential for
21 vapors to occur in the subsurface below existing and/or proposed on-site structures
22 either identified from the Phase I ESA as a REC or from this or a prior Phase II ESA,
23 the Phase II ESA shall include either a Tier 2 vapor encroachment screen (per ASTM
24 E 2600-10, Section 9 (or similar section of the most recent edition)), a vapor intrusion
25 assessment (VIA) pursuant to LSTF policy and/or procedure (as discussed in ASTM
26 E 2600-10, Appendix X7.1 (or similar section of the most recent edition)), or go
27 directly to a Tier 4 “mitigation” (per ASTM E 2600-10, Appendix X7.1 or 7.2 (or
28 similar section of the most recent edition)).

29 If a Tier 2 screen was performed and it determined that there was a VEC, a likely
30 VEC, or that a VEC could not be ruled out, either a vapor intrusion assessment (VIA)
31 pursuant to LSTF policy and/or procedure or Tier 4 “mitigation” (per ASTM E 2600-
32 10, Appendix 7.1 or 7.2 (or similar section of the most recent edition)) is required.

33 If a VIA was performed, any mitigation (or remediation) deemed necessary must
34 follow LSTF policy and/or procedure.

- 1 11. Phase II Conclusion. The Phase II ESA must conclude that:
 - 2 a. There are “hazardous substances” as defined by CERCLA, and/or of petroleum
3 and/or petroleum products at levels that exceed LSTF unrestricted criteria and list
4 any chemicals so found, or
 - 5
 - 6 b. No hazardous substances, petroleum or petroleum products have been identified
7 above de minimis levels.
- 8
- 9 12. Off-site contamination conclusion. The Phase II ESA must indicate whether there is
10 a risk of off-site contamination migrating on to the proposed site including if:
 - 11 a. There is no known or perceived off-site contamination in the vicinity of the
12 proposed site,
 - 13 b. It is unlikely that any known or perceived off-site contamination will migrate on
14 to the site, or,
 - 15 c. It is likely that known or perceived off-site contamination will migrate on to the
16 site.
- 17 13. The Phase II ESA written report must describe how it conforms to any applicable
18 LSTF requirements and must include a detailed, common language summary.
- 19 14. Exception of requirement for Phase II preparation and submission for ongoing
20 remediation. A Phase II ESA is not required when remediation is ongoing to the
21 point of not yet being an HREC (see Section 9.3.A.1.e, above), if the Phase I ESA
22 preparer states that such remediation should resolve any RECs and undecided Phase I
23 ESA issues, (see Section 9.3.A.1.f, above), and if the remediation plan preparer
24 indicates that all of the Phase II ESA requirements have been met.

25 C. Remediation Plans - General

26 Remediation plans are required if the Phase II ESA concludes that hazardous waste or
27 petroleum products are present at levels that exceed LSTF unrestricted criteria, and/or
28 that it is likely that known or perceived off-site contamination will migrate on to the site.
29 The following requirements apply to all remediation plans:

- 30 1. Complete site characterization.

- 1 a. Anytime a site has been identified from a Phase I or Phase II ESA as having
2 contamination (or contamination exposure pathways), be it vapor (gas), liquid,
3 solid, dissolved, or non-aqueous phase liquid (NAPL), above de minimis levels, a
4 complete site characterization (sometimes known as special site assessment
5 report, a detailed Phase II ESA, or a Phase III ESA) must be prepared as the initial
6 step of any remediation plan.
- 7 b. It must determine the total nature and distribution of such contamination,
8 exposure pathways, and potential receptors (a.k.a., a conceptual site model).
9 However, if the remediation plan preparer determines that the Phase II ESA
10 preparer has already determined the nature and distribution of such
11 contamination, exposure pathways and potential receptors, then such
12 determination shall be so indicated and the Phase II ESA shall be made a part of
13 the remediation plan.
- 14 c. It must be based on the appropriate combination of the following ASTM
15 Practices and Guides (or most recent editions), as determined by the remediator's
16 environmental investigator. Lesser degrees of site assessments or non-
17 conformance are not acceptable. For lead contaminated sites, refer to the listed
18 EPA Handbook.
 - 19 i. D 6235-04, "Practice for Expedited Site Characterization of Vadose Zone
20 and Groundwater Contamination at Hazardous Waste Contaminated Sites"
 - 21 ii. E 1689-95, "Standard Guide for developing Conceptual site models for
22 Contaminated Sites"
 - 23 iii. E 1903-97, "Environmental Site Assessments: Phase II Environmental
24 Site Assessment Process"
 - 25 iv. E 1912-98, "Guide for Accelerated Site Characterization for Confirmed or
26 Suspected Petroleum Releases"
 - 27 v. EPA, Superfund Lead-Contaminated Residential Sites Handbook, 2003
- 28 d. The requirements of Section 9.3.C.2, 3, and 4 must be met.
- 29 e. It must discuss how it complies with the listed Practices or Guides and/or
30 appropriate LSTF procedures, and with any LSTF regulatory requirements.
- 31 2. Any remediation studies and plans must be in the form of a report which includes a
32 detailed, common language summary.

- 1 3. The remediation plan preparer's qualifications must be discussed in any remediation
2 reports.
- 3 4. The remediation plan must cover all relevant contaminant phases: vapor (gas), liquid,
4 solid, dissolved, and NAPL.
- 5 5. The remediation plan must require either the removal of contamination to unrestricted
6 (de minimis) criteria pursuant to 9.3.D or incomplete removal of contamination to
7 restricted residential levels in the form of a Risk-Based Corrective Action pursuant to
8 9.3.E.
- 9 6. Any remediation studies and plans must be submitted to HUD with the pre-
10 application or, if the pre-application stage is omitted, with the application for Firm
11 Commitment. Evidence of approval of the remediation plan by the LSTF authority
12 must be submitted with the Application for Firm Commitment. For lenders using the
13 pre-application process, HUD will review remediation plans before an invitation
14 letter is issued.
- 15 7. If HUD determines that it is uncertain whether implementation of the remediation
16 plan will meet the requirements of either 9.3.D or 9.3.E, the remedial work must be
17 completed, including clearance testing, and the remediation itself must be approved,
18 including issuance of any clearance and closure documents, by the LSTF authority
19 prior to issuance of the Firm Commitment.
- 20 8. If the extent and cost of removing the contamination can be definitively determined,
21 and the cost of removing that contamination can be specified pursuant to a contract
22 for remediation (see Section 9.4), HUD may allow a remediation plan that has been
23 approved by the LSTF authority that:
 - 24 a. Permits the remediation including site testing, any clearance and closure
25 documents, and the approval by the LSTF, prior to Initial Endorsement, or
 - 26 b. If the applicant can show why it would be impractical to complete remediation
27 prior to Initial Endorsement, permit the remediation including site testing, any
28 clearance and closure documents, and the approval by the LSTF, prior to Final
29 Endorsement and initial occupancy.
- 30 9. All residents living regularly and construction workers working regularly on site
31 while remediation is taking place shall be informed of the remediation activities and
32 protected from any potential contamination. This requirement must be a part of the
33 remediation plan.

1 10. Remediation contract insurance. Unless HUD determines otherwise, the remediation
2 contract shall require cost cap and reopener insurance coverages, copies of which are
3 to be included in the remediation plan.

4 11. Ongoing Remediation. If remediation is taking place or has been completed but has
5 yet to receive approval by the LSTF at the time of submission of the Phase I ESA, the
6 remediation plan and all remediation studies shall be submitted, along with a detailed
7 common language summary, at the same time as the Phase I ESA.

8 D. Remediation Plans – Complete Removal of Contamination

9 1. Except for situations where Section 9.3.E (Remediation Plans Allowing for
10 Incomplete Removal of Site Contamination) applies, the lender must submit a
11 remediation plan designed to bring the contamination identified by a complete site
12 characterization per Section 9.3.C.1 to LSTF unrestricted criteria (de minimis) levels,
13 with no ongoing active or passive remediation. There must not be any need for
14 engineering controls, institutional controls, or monitoring wells.

15 2. All of the requirements for Section 9.3.C must be met.

16 3. A remediation plan that involves control of off-site contamination per Section 9.3.G
17 and/or Tier 4 vapor encroachment mitigation per Section 9.3.B.10 is not permitted
18 under this section, but may be allowed under Section 9.3.E.

19 E. Remediation Plans – Incomplete Removal of Contamination

20 1. If the costs are deemed to be exorbitant and/or the feasibility deemed impractical for
21 remediation of on-site contamination to LSTF unrestricted criteria (de minimis)
22 levels, or if there is known or expected offsite contamination that poses a risk to the
23 project site, the remediation plan may allow for incomplete removal to LSTF
24 restricted residential criteria levels, as described below.

25 2. Justification for incomplete removal of contamination must be submitted along with
26 the remediation plan and must include documentation that shows that the cost of the
27 incomplete removal of contamination, including any life cycle costs for Operation
28 and Maintenance and any applicable enforcement requirements of LSTF authorities,
29 are sufficiently below the costs of complete contamination removal, per Section 9.3.D
30 above.

- 1 3. The corrective action must be a Risk Based Corrective Action (RBCA) based on the
2 appropriate combination of:
 - 3 a. The following ASTM Guides and Practices (or most recent editions), as
4 determined by the remediator’s environmental investigator (for lead contaminated
5 sites, refer to the listed EPA Handbook):
 - 6 i. E 1689-95, “Standard Guide for developing Conceptual site models for
7 Contaminated Sites”
 - 8 ii. E 1739-95, “Standard Guide for Risk-Based Corrective Action
9 Applied at Petroleum Release Sites”
 - 10 iii. E 1943-98, “Standard Guide for Remediation of Groundwater by
11 Natural Attenuation at Petroleum Release Sites”
 - 12 iv. E 2081-00, “Standard Guide for Risk-Based Corrective Action”
 - 13 v. E 2091-05, “Standard Guide for Use of Activity and Use Limitations,
14 Including Institutional and Engineering Controls”
 - 15 vi. E 2435-05, “Standard Guide for Application of Engineering Controls
16 to Facilitate Use or Redevelopment of Chemical-Affected Properties”
 - 17 vii. WK16004, “Draft Standard Guide for Risk-Based Remedy Selection”
 - 18 viii. E 2600-10, “Standard Guide for Vapor Encroachment Screening on
19 Property Involved in Real Estate Transactions”
 - 20 ix. For Lead Contaminated Sites, “EPA, Superfund Lead-Contaminated
21 Residential Sites Handbook, 2003”
 - 22 b. LSTF regulatory procedures may be followed in lieu of the ASTM Guides and
23 Practices, as listed above, when the remediator’s environmental investigator
24 determines they are equivalent to the ASTM standards or of greater stringency.
- 25 4. The RBCA must always meet the requirements of any LSTF regulatory authority for
26 restricted residential criteria levels.
- 27 5. The RBCA report(s) must:
 - 28 a. Meet all of the requirements of Section 9.3.C;
 - 29 b. Discuss how the remediation plan complies with the applicable ASTM Guides
30 and Practices and/ or LSTF regulatory procedures as discussed in Sections
31 9.3.E.3, above;

- 1 c. Discuss how it meets or will meet all of the requirements of Section 9.3.E.6; and
2 d. Discuss how it meets or will meet all of the requirements of Section 9.3.F through
3 J.
- 4 6. The RBCA must be supported by the applicable combination of:
- 5 a. Engineering and Institutional Controls (EC/IC).
- 6 i. An appropriate mix of engineering controls such as capping and slurry
7 walls, and institutional controls such as protective covenants and access
8 restrictions are usually required for all RBCAs, shall follow the guidance in
9 ASTMs E 2435-05 and E 2091-05 (or most recent editions), and must
10 indicate how it met these Guides. LSTF regulatory provisions may be
11 followed in lieu of these ASTM Guides, as amended when the remediator's
12 environmental professional determines their equivalence.
- 13 ii. Operations and Maintenance Plan (O&M) Plan. Any time there is an EC/IC
14 there must be an O&M plan which itself is an IC. The O&M plan must be
15 approved by the LSTF authority, and must discuss any associated
16 enforcement required by LSTF authorities. An O&M plan must be in place
17 for management of all contamination remaining on the site and any controls
18 thereof. If HUD determines that the mortgagor does not have sufficient
19 capacity to manage the O&M plan, the mortgagor must contract an
20 appropriate servicer to do so. (See Section 9.4. for costing.)
- 21 iii. Hard/Soft Cap Engineering Control. A hard cap EC, such as concrete,
22 generally is required if any contamination will remain on the site after Final
23 Endorsement. Unless the applicant can justify why a lesser depth to
24 contamination would be protective of the health and safety of occupants, the
25 depth of any remaining contamination should be greater than:
- 26 • the depth of the foundations of any existing or proposed structures
27 including sumps;
- 28 • the depth of any existing or proposed utilities on site; or
- 29 • five feet below the surface.
- 30 HUD may allow for a soft cap (e.g. dirt) if other engineering controls such
31 as an impenetrable geotextile fabric are included. If EC are not required for
32 a soft cap, IC is still required.

- 1 iv. Slurry Wall or Equivalent Engineering Control. A slurry wall or equivalent
2 type EC may be required to prevent offsite contamination from migrating
3 onsite or to prevent onsite contamination from migrating onsite or offsite. If
4 the Phase I and/or Phase II ESA determines that the likely existence of off-
5 site contamination presents a risk to the site, such a slurry wall or equivalent
6 type EC will be required.
- 7 v. Monitored Natural Attenuation and Enhanced Passive Remediation
8 (MNA/EPR). MNA/EPR such as by bio-augmentation where no additional
9 active input is required and passive engineering controls such as a slurry
10 wall may be allowed as part of the RBCA. In such cases, the LSTF
11 authority must issue a conditional No Further Action Letter or similar
12 approval. Monitoring wells pursuant to the above RBCAs and meeting the
13 requirements of Section 9.3.F will be required to monitor the progress of the
14 remediation. When MNA/EPR is part of the RBCA, the remediation may
15 continue beyond Initial Endorsement provided that the LSTF authority has
16 determined in writing that such undertakings would present no threat to
17 health, safety or the environment.
- 18 vi. Vapor Encroachment/Vapor Intrusion Mitigation. If a VEC is present, a
19 VEC is likely present, or a VEC cannot be ruled out, then mitigation as
20 discussed in ASTM E 2600-10, Section 7.2 (or similar section of the most
21 recent edition) is required, unless a VIA has been, or will be, performed
22 pursuant to LSTF policy and/or procedure. When remediation goes directly
23 from a Tier 1 screen or a Tier 2 screen, such controls shall, where feasible,
24 consist of a poured-on vapor barrier to be used in conjunction with active
25 and passive venting systems.
- 26 vii. IC regarding groundwater contamination, if applicable, must be put in place.
- 27 b. No Further Action Letter (NFA). The LSTF authority must issue an NFA, or
28 similar approval, except that a conditional NFA may be allowed pursuant to
29 MNA/EPR (see 9.3.E.6.a.v). The LSTF authority must indicate in the NFA that
30 the remediation that has taken place or will take place is protective of health,
31 safety and the environment. The NFA must be submitted to HUD pursuant to the
32 timeline required by 9.3.C.7 and 9.3.C.8, namely:
- 33 i. If HUD determines that it is uncertain whether implementation of the
34 remediation plan will meet the requirements of this section, the

1 remedial work must be completed, including clearance testing, and the
2 remediation itself must be approved, including issuance of any
3 clearance and closure documents, by the LSTF authority prior to
4 issuance of the Firm Commitment.

5 ii. If the extent and cost of removing the contamination can be
6 definitively determined, and the cost of removing that contamination
7 can be specified pursuant to a contract for remediation (see Section
8 9.4), HUD may allow a remediation plan that has been approved by
9 the LSTF authority that:

10 1. Permits the remediation including site testing, any clearance
11 and closure documents, and the approval by the LSTF, prior to
12 Initial Endorsement, or

13 2. If the applicant can show why it would be impractical to
14 complete remediation prior to Initial Endorsement, permits the
15 remediation including site testing, any clearance and closure
16 documents, and the approval by the LSTF, prior to Final
17 Endorsement and initial occupancy.

18
19 c. Groundwater Requirement. A site is or will be otherwise acceptable if
20 contamination exists in the groundwater after completion of remediation, if:

21 i. IC regarding the groundwater is/will be put in place, along with an O&M
22 plan, approval by the LSTF authority, and any applicable enforcement
23 requirements of LSTF authorities. The ICs must prohibit any and all uses of
24 the groundwater;

25 ii. The highest anticipated levels of groundwater based on high groundwater
26 and/or 100 year flooding events, are below the levels of any construction or
27 potentially anticipated utility work unless it can be shown how such high
28 groundwater levels will not modify the horizontal and vertical extent of
29 contamination to such a degree that it could affect the health and safety of
30 residents and workers; and

31 iii. Any vapors from groundwater and/or soils are shown not to present a
32 significant risk pursuant Tier 1 vapor encroachment assessment, Tier 2
33 vapor encroachment assessment, VIA, or mitigation.

- 1 d. Safety of and Disclosure to Residents and Workers. Any time contamination
2 above de minimis levels is allowed to remain on site after initial occupancy and
3 final closing, all maintenance workers who might perform activities that could
4 compromise the EC/IC, construction workers, and building residents, etc. are to
5 be informed of the general type and extent of contamination and the protective
6 measures that have been taken. It would be up to residents to inform any of their
7 visitors/guests of these conditions.
- 8 e. Hazardous Substance Quantification. If any RBCA remediation plan identifies
9 hazardous substances (listed in 40 CFR 302.4) that will remain on the property
10 after Final Endorsement, such plan shall determine the quantity of such hazardous
11 substances and whether it exceeds the levels indicated at 40 CFR 373.2(b). (This
12 is a requirement under CERCLA that would apply to HUD at any, time that HUD
13 might own the property or take over its management.)

14 F. Monitoring Wells, Flushing Wells, or Testing Wells

- 15 1. General Requirements. The presence of a testing or monitoring well on the property
16 does not bar the property from consideration for mortgage insurance. If a monitoring
17 well is required to confirm that contaminants have been removed to intended levels or
18 that an MNA/EPR is working properly, EC/IC will be required until such time as
19 contaminants are reduced to de minimis levels and a Final NFA letter is issued.
- 20 2. Monitoring Well Protocols. Monitoring protocols must be specified in the RBCA and
21 monitoring must proceed until contaminants have been removed to intended levels or
22 that passive MNA/EPR is working properly.
- 23 3. Off-site Contamination – Acceptability. If a monitoring well is required to determine
24 if existing or assumed off-site contamination has migrated or might migrate on-site,
25 the site is generally not acceptable unless associated EC/IC are put in place pursuant
26 to a RBCA or unless the LSTF authority provides a statement that such off-site
27 contamination would not present a risk to the health of the project’s occupants if it
28 were to migrate on-site.
- 29 4. Flushing Wells – Unacceptable. In no case may Final Endorsement/initial occupancy
30 take place when a flushing well is in operation or will be required.
- 31 5. Testing or Monitoring Wells Ordered by LSTF. A testing or monitoring well may
32 also be placed on the property by order of the LSTF to test or monitor contamination

1 on the site or from a neighboring site. If a monitoring well would be required or
2 exists solely to monitor the general health of an aquifer used as a water supply or
3 potential water supply, but not in relation to an existing or potential hazardous
4 condition, this is not a bar to environmental approval. However, the lender must
5 notify HUD if there is any current or intended placement of a monitoring or testing
6 well.

- 7 6. Non-operating Wells. Non-operating wells are not a bar to environmental approval,
8 but must be capped over and closed out pursuant to the appropriate LSTF authority.

9 G. Off-site Contamination

10 If the Phase I and/or Phase II ESA determine that the existence of off-site contamination
11 presents a risk to the site or the residents of the project and the sponsor has no control
12 over the off-site locations of the contamination, the site is not acceptable unless such off-
13 site contamination is subject to a RBCA meeting all of the requirements of Sections 9.3C
14 and E.

15 H. Escrow

16 An escrow account must be set up and held by the lender for the maintenance of any
17 monitoring wells and engineering controls, such as caps or slurry walls.

18 I. Waivers

19 If a Regional Center Regional Office intends to waive any of the requirements in this
20 Section 9.3 that are not regulatory in nature, the advice of the Departmental and/or
21 Housing Environmental Officer or one of the Field Office Environmental Officers should
22 be obtained before the waiver is granted to ensure that such waiver is in compliance with
23 the environmental requirements of 24 CFR 50.3(i).

24 J. LSTF Approvals and Reviews

25 Any approvals by an LSTF authority must be given directly by that authority and may not
26 be given by a third party approved by that authority to act in lieu of the authority itself.
27 Approvals by local authorities are only acceptable when such authority is acting under
28 delegation from the State.

29 K. Unacceptable Sites

1 A site over a former solid waste landfill/dump and/or Superfund (National Priorities List
2 (NPL)) site generally is not acceptable for development unless the hazardous substances,
3 petroleum, and petroleum products are completely removed, the site is delisted, or for an
4 NPL site only, the Federal Agency with management authority over the site gives written
5 approval of the site for residential usage.

6 **9.4 HUD Staff Responsibilities in Reviewing Cases** 7 **Requiring Remediation**

8 A. General Responsibilities

9 The Department assumes greater risk anytime that a Firm Commitment is issued on a
10 contaminated site, which risk is even greater when a loan is on a site where complete
11 removal of contamination is not possible, requiring monitoring possibly with continuous
12 remediation techniques such as MNA/EPR. Therefore, HUD staff must exercise great
13 care in the review process to assure that all reasonable measures are taken to mitigate
14 HUD's risk exposure and that an accurate determination is made of any remediation costs
15 that are included in the HUD-insured mortgage. Any special site assessment reports,
16 Phase II or Phase III ESAs should be reviewed so that the extent of the contamination is
17 fully understood. Although the lender is responsible for assuring that environmental
18 remediation contractors are qualified and experienced, field staff must still review
19 references and qualifications and are strongly encouraged to consult with their field
20 environmental officer.

21 22 B. Complete Removal of Site Contamination

- 23 1. Valuation. Valuation is generally responsible for the review of all environmental
24 documentation and for the preparation of the SFNC and the Form HUD-4128,
25 which may be supplemented as needed to document the review and Valuation's
26 conclusions as to the adequacy of the proposed remediation plan.

27 Any estimates of value or rents should be made as if the project is unaffected by
28 contamination and conditioned on successful removal. The appraisal must
29 address any effect of marketability that may be present due to the prior
30 environmental history.

- 1 2. A/E and Cost. The A/E and Cost staff are responsible for determining if the cost
2 estimate of the remediation plan is reasonable and if the remediation and removal
3 contractor is appropriately bonded and qualified. Cost data for remediation is not
4 as plentiful as with more routine construction tasks. “Environmental Remediation
5 Estimating Methods” might be helpful in some cases and is available through RS
6 Means at <http://www.rsmeans.com>. In addition, the A/E and Cost staff may
7 consult with local environmental remediation professionals about costs for similar
8 work.
- 9 3. Mortgage Credit. Mortgage Credit shall administer escrow, performance and
10 bond payment requirements. The amount of the escrow or bond shall be based on
11 the estimated cost of the mitigation work from the contractor, at 150% of the
12 estimated cost, or in an escrow established for the same amount. The cash
13 requirements for the escrow or bond, and the lender and Mortgage Credits
14 procedures for administering the escrow, shall be in accordance with existing
15 closing instructions in the FHA Multifamily Program Closing Guide. Higher
16 escrow or bonding requirements will be necessary if the appraiser and/or the
17 environmental officer determine that there is a greater than average risk that
18 unforeseen problems may arise, resulting in increased cost, based on previous
19 experience with similar work and/or research through local environmental
20 remediation contractors about their experience in containing the cost within their
21 stated estimate.

22 C. Incomplete Removal of Site Contamination

- 23 1. All disciplines should follow the guidance in Section 9.4.B regarding initial
24 removal or mitigation costs.
- 25 2. Valuation must assure that the MAP Underwriter included on Form HUD-92264,
26 the cost of any requirement for continuous monitoring and/or mitigation. This
27 may be accomplished by including this cost in Section E of the HUD-92264 under
28 “Other Maintenance” and would include fees charged by service providers who
29 are engaged to perform monitoring. If an expense is for actual or anticipated
30 replacement of a component such as a pump, it should be included in the Reserves
31 for Replacement. The basis for the expense or additional replacement reserve will
32 be obtained from a qualified engineer and/or contractor. The
33 engineer/contractor’s estimate should be sufficiently detailed and supported to
34 allow review by the A/E & Cost staff as well as the Valuation staff.

1 Any effect on project marketability, value or rents due to the need for continuous
2 monitoring/mitigation must be quantified and discussed in the appraisal.

3 D. Management, Coordination and Communication

4 The Department assumes greater risk in cases involving environmental mitigation that
5 will occur after Initial Endorsement especially when mortgage proceeds are used to fund
6 the cost of remediation. Extra attention must be given to the need for frequent
7 communication, preferably with written documentation, between disciplines that are
8 coordinated by team leaders and Regional Center Regional Office Directors relating to
9 levels of contamination, cost estimates and the certainty of the effectiveness of
10 mitigation.

11 E. Insurance/Guarantee Requirements

12 Borrowers are required to obtain separate insurance for environmental hazards from an
13 insurer acceptable to HUD if remediation work will be done on the site during the insured
14 loan period, if the coverage is available. Environmental hazard insurance typically
15 covers liability and cost of completion.

16 The environmental remediation contractor will almost always be different from the
17 project's general contractor. Aside from the contractor qualifications, licensure and
18 bonding that are addressed above, the remediation contractor must provide HUD a
19 separate guarantee of completion for their work on a form prescribed by HUD.

20 **9.5 Environmental Report**

21 The lender must submit a narrative Environmental Report to provide information regarding
22 compliance with the NEPA environmental factors, the laws and authorities listed at 24 CFR
23 50.4, and the HUD-specific requirements described herein, as applicable, as well as any issues
24 that might affect the acceptability of the project, including any issues of compliance with state
25 environmental laws. Each authority must be addressed, unless a CE applies (see 9.1.A.4 and
26 9.1.A.5, above) or an exception is otherwise noted below. If a CE or other exception applies, the
27 application or Environmental Report must include a statement to that effect. The Environmental
28 Report must include and appropriately cite supporting documentation. The failure to submit
29 applicable supporting documentation may cause delays in the environmental review process.

1 The information below provides background information on some of these authorities; more
2 information can be found in the authorities. The Environmental Report must be submitted at
3 pre-application for those lenders using the pre-application process, or at the application for Firm
4 Commitment stage for others. HUD may request additional data or studies to comply with these
5 requirements.

6

7 The following environmental issues must be included as applicable:

- 8 A. Lead-Based Paint
- 9 B. Asbestos
- 10 C. Radon
- 11 D. Historic Preservation
- 12 E. Floodplain Management
- 13 F. Wetlands Protection
- 14 G. Endangered Species
- 15 H. Noise Analysis
- 16 I. Explosive/Flammable Hazards
- 17 J. Coastal Barrier Resources
- 18 K. Coastal Zone Management
- 19 L. Sole Source Aquifers
- 20 M. Airport Clear Zones
- 21 N. Environmental Justice
- 22 O. Other Federal or State Laws
- 23 P. Additional Hazards and Nuisances

1 The issues discussed in detail below must be analyzed by HUD staff during their preparation of
2 the Form HUD-4128 and SFNC and provide guidance by which the lender can assist HUD.
3 These brief descriptions are not substitutes for the requirements in the statutes, regulations,
4 Executive Orders, and handbooks. Note that Item 23 “Toxic Chemicals and Radioactive
5 Materials” of both the SFNC and the Form HUD-4128 should be included in the Phase I ESA
6 discussed above.

7

8 A. Lead-Based Paint (24 CFR Part 35)

9 1. Lead-based paint requirements are applicable to multifamily housing constructed
10 before 1978, in accordance with 24 CFR Part 35.

11 Exceptions:

12 a. The project is proposed for demolition provided the property will remain
13 unoccupied until demolition;

14 b. The housing is designated exclusively for the elderly or persons with disabilities,
15 unless a child of less than 6 years of age resides or is expected to reside there.

16 c. Zero-bedroom dwelling units.

17 2. HUD regulations regarding lead-based paint are found at 24 CFR Part 35, copies of
18 which, along with guidance materials, may be downloaded from
19 <http://www.hud.gov/offices/lead/enforcement/lshr.cfm> or obtained by telephoning 1-
20 800-424-LEAD. The helpful Lead Rule Compliance Advisor is available at
21 <http://portalapps.hud.gov/CorvidRpt/HUDDLBP/welcome.html>.

22 3. For pre-1960 residential properties that do not involve conversions or major
23 rehabilitation, the lead-based paint report shall consist of a risk assessment to identify
24 lead-based paint hazards, performed in accordance with 24 CFR 35.1320(b), by a
25 certified lead-based paint risk assessor. Any identified lead-based paint hazards must
26 be treated with “interim controls” in accordance with 24 CFR 35.1330 and shall be
27 considered to be completed when clearance is achieved in accordance with 24 CFR
28 35.1340. Interim controls generally should be completed prior to issuance of the
29 Firm Commitment, but with HUD approval, may be completed prior to Final Closing
30 under conditions in the Firm Commitment which require an escrow of sufficient
31 repair or rehabilitation funds. , Before issuance of the Firm Commitment ongoing
32 lead-based paint maintenance must be incorporated into regular building operations

- 1 and maintenance activities in accordance with 24 CFR 35.1355(a). The building
2 owner must agree to incorporate ongoing lead-based paint maintenance operations
3 and maintenance plans into routine building operations. See 24 CFR 35.620.
- 4 4. For multifamily properties constructed after 1959 and before 1978 that do not involve
5 conversions or major rehabilitation, the Firm Commitment shall require that ongoing
6 lead-based paint maintenance practices be included into regular building operations in
7 accordance with 24 CFR 35.1355(a). The owner must agree to incorporate ongoing
8 lead-based paint maintenance practices, as specified in the regulation, into routine
9 building operations. See 24 CFR 35.625
- 10 5. For conversions and major rehabilitations (defined as “rehabilitation that is estimated
11 to cost more than 50% of the estimated replacement cost after rehabilitation”), a
12 “lead-based paint inspection” to identify the presence of lead-based paint shall be
13 performed in accordance with 24 CFR 35.1320(a), by a certified lead-based paint
14 inspector. The Firm Commitment shall require that any lead-based paint identified on
15 the property shall undergo “abatement” in accordance with 24 CFR 35.1325 with the
16 abatement to be completed prior to both initial occupancy and Final Closing. HUD
17 will generally require that such abatement be achieved through paint removal or
18 component replacement. However, if the sponsor can demonstrate that paint removal
19 or component replacement is not practicable because the substrate material is
20 architecturally significant and would be damaged by so doing, HUD may approve
21 permanent encapsulation or enclosure and incorporation of ongoing lead-based paint
22 maintenance into regular building operations maintenance activities. Abatement is
23 considered complete when clearance is achieved in accordance with 24 CFR 35.1340.
24 See 24 CFR 35.630.
- 25 6. An application for insurance in connection with a refinancing transaction where an
26 appraisal is not required under the applicable procedures established by HUD is
27 exempt from these requirements.
- 28 7. For these three types of properties, if an evaluation or hazard reduction is undertaken,
29 the sponsor shall provide a notice to occupants in accordance with 24 CFR 35.125.
30 The sponsor shall also provide the lead hazard information pamphlet in accordance
31 with 24 CFR 35.130.
- 32 6. The cost of lead-based paint abatement or hazard control work may be included in the
33 proposed mortgage loan with HUD approval.

- 1 7. Most sale and rental transactions are also subject to the HUD-EPA lead-based paint
2 disclosure rules at 24 CFR Part 35, Subpart A.

3
4
5
6
7 B. Asbestos (24 CFR 50.3(i))

- 8 1. While many uses of asbestos are technically allowed today, several uses of asbestos
9 have been banned starting in the early 1970s, and many commercial enterprises have
10 stopped installing asbestos products as of the late 1970s. Some of the more common
11 examples of asbestos containing materials include insulation, sprayed on finishes,
12 such as ceilings, vinyl floor tile and the adhesive to fix the tile in place, siding, and
13 roofing. Asbestos studies and information must be included in the Environmental
14 Report, in accordance with HUD's environmental policy articulated at 24 CFR
15 50.3(i), that properties proposed for use in HUD programs be free of hazardous
16 materials, contamination, toxic chemicals and gasses, and radioactive substances,
17 where a hazard could affect the health and safety of occupants or conflict with the
18 intended utilization of the property. Asbestos must be addressed by the sponsor's
19 architect. See Chapter 5 Section 5.15.A.3 and Appendices 5B and 5C.
- 20 2. For any structures on the site built before 1978 which are to be demolished, a
21 comprehensive building asbestos survey by a qualified asbestos inspector is required.
22 It must be performed pursuant to the "pre-construction survey" requirements of
23 ASTM E 2356-10, "Standard Practice for Comprehensive Building Asbestos
24 Surveys" (or most recent edition).
- 25 3. Other than for structures to be demolished, on any building built before 1978, a
26 qualified asbestos inspector must perform a comprehensive building asbestos survey
27 pursuant to the "baseline survey" requirements of ASTM E 2356-10, "Standard
28 Practice for Comprehensive Building Asbestos Surveys" (or most recent edition). In
29 those cases where suspect asbestos is found, it should either be assumed to be
30 asbestos or should require confirmatory testing.

- 1 3. If there is asbestos and it is friable or damaged, HUD requires that it be removed. If
2 asbestos is not friable or damaged, HUD strongly recommends that at a minimum it
3 be encapsulated, which would be incorporated in an O&M plan.
- 4 4. The asbestos survey must be submitted with the application as part of the
5 Environmental Report. If the survey identifies asbestos or asbestos is assumed, HUD
6 will condition the Application for Firm Commitment on an appropriate mix of
7 asbestos abatement and an asbestos O&M plan.
- 8 4. Other than for asbestos abatement on a structure that will be completely demolished,
9 the cost of any asbestos abatement activities may be included in the proposed
10 mortgage loan.
- 11 5. All asbestos abatement shall be done in accordance with EPA requirements for air
12 pollution prevention pursuant to 40 CFR, subpart M especially, 40 CFR 61.145 and
13 OSHA requirements for Worker Protection, pursuant to 29 CFR 1926.1101, and any
14 LSTF asbestos abatement and worker protection rules. All asbestos abatement must
15 be performed by a qualified asbestos abatement contractor.

16 C. Radon (supersedes ML 2013-07)

- 17 1. Background. One common constituent of soil and rock is the unstable element
18 uranium. One of the decay products of uranium is radon, a colorless, odorless gas.
19 Under certain natural conditions, the radon gas can enter surface soils and become
20 part of the “soil gas” environment, which then can enter the air, including air inside of
21 buildings. When soil gas that contains radon enters a building, radon and its decay
22 products are either directly inhaled, or attached to dust on walls, floors and in the air,
23 which then can be inhaled. These decay products then undergo further decay,
24 resulting in the release of subatomic alpha particles. This alpha particle radiation can
25 cause mutations in lung tissue which can lead to lung cancer. The risk of contracting
26 lung cancer from radon increases with an increase in the concentration of radon in the
27 air that is breathed by building occupants. EPA recommends mitigation for residences
28 with radon concentrations at or above 4 picocuries per liter of air (pCi/L).
- 29 2. General Requirements
- 30 a. Radon Report.

- 1 i. The Radon Report is required for all MAP or TAP applications, unless
2 an exception listed in Section 9.5 C.2.a.3 applies.
- 3 ii. The Radon Report shall be included in the pre-application, or
4 application, as applicable.
- 5 iii. Contents. The Radon Report shall include the results of any testing
6 performed, the details of any mitigation deemed necessary, and the
7 timing of any such mitigation. An amended Radon Report must be
8 issued if the testing and/or mitigation must occur after application
9 submittal according to the requirements below. The Radon Report
10 must be signed and certified as to its compliance with the requirements
11 of this section by a Radon Professional.
- 12 b. Radon Professional.
 - 13 i. All testing and mitigation must be performed under the direct
14 supervision of a Radon Professional, in accordance with the protocols
15 referenced in this section.
 - 16 ii. Radon Certification/License of the Radon Professional is required as
17 follows:
 - 18 a. Certification from either the American Association of Radon
19 Scientists and Technologists (AARST) National Radon
20 Proficiency Program (NRPP) or the National Radon Safety
21 Board (NRSB); and
 - 22 b. Certification/License from the state in which the testing or
23 mitigation work is being conducted, if the state has this
24 requirement.
- 25 c. Exception to Testing and Mitigation requirements.
 - 26 i. A Radon Professional may conclude that neither testing nor mitigation
27 is necessary based on a physical inspection of the property, the
28 characteristics of the buildings, and other valid justifications. An
29 example of a valid justification is having only a garage on the surface
30 level that is open to the air and is fully ventilated. Any such

1 justifications as to why neither testing nor mitigation is necessary must
2 be provided in the Radon Report.

- 3 ii. A Radon Report is not required for Section 223(f) project applications
4 that have a low radon risk. To determine whether the project's radon
5 risk is low, the lender must first establish that the project is located Zone
6 3 of the EPA Map of Radon Zones (available at:
7 <http://www.epa.gov/radon/zonemap.html>). Then the lender must
8 consult any published and readily available state or local radon
9 potential data or maps to confirm the radon risk is low. If such
10 information indicates a low radon risk, the lender must provide
11 appropriate documentation.
- 12 iii. A Radon Report is not required for applications that are categorically
13 excluded under 24 CFR 50.19(b)(21) (see 9.1.A.5, above).
- 14 iv. Applicants are encouraged to test for radon even if a Radon Report is
15 not required per the exceptions above. Any such testing must follow
16 the Testing Protocols and Resident Notification protocols below, and
17 must then be incorporated within a Radon Report as described within
18 this section. If the results of such testing indicate levels of radon above
19 the threshold for unacceptability, mitigation as described in this
20 section is required, with the mitigation requirements for Section
21 223(a)(7) projects the same as those for 223(f) projects.

22 d. Testing Protocols.

- 23 i. Radon testing must follow the protocols set by the American
24 Association of Radon Scientists and Technologists, Protocol for
25 Conducting Radon and Radon Decay Product Measurements in
26 Multifamily Buildings (ANSI-AARST MAMF-2012, Section III, or
27 similar section in the most recent addition) (available at
28 <http://aarst.org/bookstore.shtml>).

29 Exception: With reference to Section III.3.1 of ANSI-AARST MAMF-
30 2012 (or similar section in the most recent edition), the minimum
31 number of areas to be tested shall be at least twenty-five percent of
32 randomly selected ground level units/rooms in each building. All of

- 1 the other requirements at Section III.3 of ANSI-AARST MAMF-2012
2 (or similar section in the most recent edition) shall be followed.
- 3 ii. Threshold for unacceptability: 4.0 picocuries per liter (4.0 pCi/L)
4 based on initial and any confirmatory testing, if performed.
- 5 e. Occupant Notification.
- 6 i. Testing. Occupants of all new applications for Multifamily MAP
7 and TAP mortgage insurance programs shall be informed of
8 forthcoming testing in the manner described in AARST MAMF-
9 2012, Section II.B and Section III. 2.2.1 (or similar sections in
10 the most recent edition).
- 11 ii. Mitigation. Occupants shall be informed both prior to and after
12 mitigation activities. In the case of new construction, incoming
13 occupants shall be informed of radon mitigation activities.
- 14 f. Mitigation Standards. Mitigation is required for any building where any
15 unit(s) exceeds the threshold for unacceptability. The Radon Professional
16 must assure that mitigation, when required, conforms to the following
17 standards.
- 18 i. Existing buildings: ASTM E2121-11 (or most recent edition),
19 Standard Practice for Installing Radon Mitigation Systems in
20 Existing Low-Rise Residential Buildings (available at
21 <http://www.astm.org/Standards/E2121.htm> and/or the AARST
22 [Mitigation Standards for Multifamily Buildings when](#)
23 [published](#)).
- 24 ii. New construction: ASTM E1465-08a (or most recent edition),
25 Standard Practice for Radon Control Options for the Design and
26 Construction of New Low-Rise Residential Buildings (available
27 at <http://www.astm.org/Standards/E1465.htm>).
- 28 g. Mitigation Timing. For new construction and substantial rehabilitation
29 properties, all mitigation, including follow-up testing, must be
30 completed prior to Final Closing. Radon mitigation included as part of a
31 Section 223(f) project's repairs must be completed as quickly as

- 1 practicable, and in any event, no later than 12 months after Initial
2 Closing.
- 3 h. Certificate of completion. A certificate of completion from the Radon
4 Professional must be submitted and appended to the Radon Report once
5 radon testing and/or mitigation is completed.
- 6 i. Cost estimate. Use detailed plans and specifications supplied by the
7 lender's architectural analyst as required by MAP Guide, Section 5.5, as
8 a basis for the cost estimate. Estimates must reflect the general level of
9 construction costs in the locality where construction takes place. Costs
10 must be projected to the estimated construction start date.
- 11 3. Section 223(f).
- 12 a. All Section 223(f) projects located within high risk (Radon Zone 1) and medium risk
13 (Radon Zone 2) zones must be tested for radon.
- 14 i. Testing must be performed no earlier than 1 year prior to application
15 submission.
- 16 ii. Exception: The applicant may elect to proceed directly to mitigation
17 without testing.
- 18 b. Mitigation.
- 19 i. Mitigation must follow ASTM E2121-11 (or most recent edition)
20 and/or the AARST Mitigation Standards for Multifamily Buildings,
21 when published
- 22 ii. If estimated costs exceed the allowable cost for the Section 223(f)
23 program, the application cannot be approved but may be considered
24 under the substantial rehabilitation program.
- 25 4. Substantial Rehabilitation and Conversions.
- 26 (Applies to all Radon Zones)
- 27 a. Testing prior to substantial rehabilitation or conversion.
- 28 i. Early testing not feasible. For some proposals, such as a

1 conversion of an existing structure from non-residential to
2 residential, the building envelope may change to such an extent
3 that early testing would not be appropriate and in some cases not
4 possible. If this is the case, proceed directly to mitigation as
5 discussed at Section 9.5 C.4.b.

6 ii. Early testing when feasible.

7 a. Must be performed no earlier than 1 year prior to
8 application submission.

9 b. If test results are below the threshold, no mitigation is
10 required.

11 c. If test results are at or above the threshold, mitigation must
12 be built into the project design per Section 9.5.C.4.b.i.

13 b. Mitigation.

14 i. If mitigation is built into project design, it must be conducted in
15 accordance with ASTM E2121-11 (or most recent edition) and/or
16 the AARST Mitigation Standards for Multifamily Buildings,
17 when published.

18 ii. If mitigation is not built into project design, after construction is
19 complete but prior to Final Closing, radon testing must be
20 conducted. If testing results are above the threshold, retrofit
21 pursuant to ASTM E2121-11 (or most recent edition) is required,
22 and /or the AARST Mitigation Standards for Multifamily
23 Buildings, when published.

24 5. New Construction.

25 a. Radon resistant construction is required for all radon zones.

26 b. Radon Zone 1

27 i. Construction Requirements: All new construction in Radon Zone
28 1 must meet all of the requirements of ASTM E1465-08a (or
29 most recent edition) for installation of passive systems.

1 ii. Post-construction testing is required prior to Final Closing. If
2 testing results are above the threshold, conversion from a passive
3 system to a fan-powered system pursuant to ASTM E1465-08a
4 (or most recent edition) is required.

5 c. Radon Zones 2 and 3

6 i. Construction requirements.

7 a. Gas permeable layer. The gas permeable layer must meet
8 all of the requirements of ASTM E1465-08a, Section 6.4
9 (or similar section in the most recent edition).

10 b. Ground cover. The concrete slabs and plastic membranes
11 that seal the top of the gas permeable layer must meet all of
12 the requirements of ASTM E 1465-08a, Section 6.2 (or
13 similar section in the most recent edition).

14 c. Foundation walls. Foundation walls must meet all of the
15 requirements of ASTM E1465-08a, Section 6.3 (or similar
16 section in the most recent edition).

17 ii. Post construction testing is required, except as provided at 9.5
18 C.2.c.

19 a. Radon testing must be performed after construction is
20 complete, but prior to Final Closing.

21 a. If testing results are above the threshold, retrofit based on
22 ASTM E2121-11 (or most recent edition) is required, with
23 installation of a passive system. If testing results remain
24 above threshold, a fan-powered system pursuant to ASTM
25 E1465-08a (or most recent edition) is required.

26 D. Historic Preservation (24 CFR 50.4(a))

27 1. HUD must follow the procedures implementing the National Historic Preservation
28 Act (54 U.S.C. 300101 et seq.) with regulations found at 36 CFR Part 800. Section
29 106 of the National Historic Preservation Act (NHPA) requires Federal agencies to
30 take into account the effects of their undertakings on historic properties and to afford

1 the Advisory Council on Historic Preservation a reasonable opportunity to comment.

- 2
- 3 2. Applications for Firm Commitment, whether for new construction, rehabilitation,
4 refinancing or conversion from non-residential to residential property are considered
5 “federal undertakings” which require HUD to make a determination of no historic
6 properties affected, no adverse effect, or adverse effect upon historic properties. An
7 historic property means any prehistoric or historic district, site, building, structure,
8 object, or traditional property or landscape included in, or eligible for inclusion in, the
9 National Register of Historic Places maintained by the Secretary of the Interior.
10 Also, HUD must consider the area of potential effect (APE), which is often the site
11 boundary, but occasionally the block on which the site is located or the immediate
12 site environs. Because of the technical nature of historic property identification,
13 evaluation and treatment, it may be appropriate to retain a qualified historic
14 preservation professional to prepare the determination. Such consultant should meet
15 the Secretary of the Interior’s Professional Qualifications (36 CFR Part 61) and have
16 experience in Section 106 reviews.

17
18 Exceptions (if applicable, a statement identifying the exception and supporting
19 documentation must be included in the application):

- 20
- 21 a. Categorical exclusions under 24 CFR 50.19(b)(21) (see 9.1.A.4, above);
- 22 b. HUD has made the determination that 223(f) refinance transactions that will not
23 allow rehabilitation nor result in any physical impacts or changes except for
24 routine maintenance have “no potential to cause effects” to historic properties, as
25 described in 36 CFR 800.3(a)(1), and therefore have no further obligations under
26 Section 106 of the Historic Preservation Act or 36 CFR Part 800. For such
27 transactions, the applicant is not required to contact the State Historic
28 Preservation Officer (SHPO), and HUD staff historic preservation responsibilities
29 are limited to documenting this determination in the form HUD-4128;
- 30 c. Some states may have a Programmatic Agreement (PA) with HUD and the
31 proposal may be part of a class of actions that do not require Section 106
32 consultation under the PA.

- 1 3. Pursuant to the “anticipatory demolition” requirements of Section 110(k) of the
2 National Historic Preservation Act (54 U.S.C. 306113), even before the concept
3 meeting or application submission takes place, any action by a potential lender or
4 borrower, or any action by another party that the lender or borrower has the legal
5 power to prevent, that is taken with the intent to -circumvent Section 106 review and
6 that significantly adversely affects a historic property, could result in rejection of an
7 application.
8
- 9 4. If an exception does not apply, to assist HUD in making its historic preservation
10 determinations, the borrower or lender should submit a letter to the appropriate SHPO
11 consisting of a narrative explaining the proposal, and should follow the procedures
12 outlined by the individual state. The letter should include a map identifying the site
13 location, the APE, and an opinion as to whether the proposal would have any effect
14 on historic properties. Because of the technical nature of historic property
15 identification, evaluation and treatment, it may be appropriate to retain a qualified
16 historic preservation professional to prepare the letter. Such consultant should meet
17 the Secretary of the Interior’s Professional Qualifications (36 CFR Part 61) and have
18 experience in Section 106 reviews. The letter, any referenced documentation, and the
19 SHPO response, if any, must be included in the environmental report. Lenders may
20 obtain from the HUD office the name and address of the SHPO who has the right to
21 comment on the proposal. The SHPO is allowed 30 days (from the receipt of
22 sufficient information from HUD) to reply to requests for consultation. If a response
23 is not received, the lender must alert HUD of this fact in their application. Some
24 SHPOs will only respond to Federal agencies. Note that HUD, not the lender, is
25 responsible for contacting the Tribal Historic Preservation Officer (THPO) and any
26 affected tribes (see 36 CFR 800.2 and 800.3). The information contained in the letter
27 that was submitted to the SHPO as described above will assist HUD in carrying out
28 its tribal and THPO consultations.
29
- 30 5. After a SHPO response has been received or 30 days have elapsed, HUD must make a
31 determination of effect. HUD will review the SHPO letter and other information for
32 sufficiency, and if appropriate may request additional information or engage in
33 further consultation with the SHPO. If HUD determines there is no effect a
34 commitment may be issued. Where an undertaking will affect a historic property or
35 historic district, HUD will direct the consultation process, which may result in a
36 design change, research and preservation, salvage, or in rare cases, rejection of the
37 application for Firm Commitment. Consultation for these procedures may take
38 considerable time before a commitment can be issued.
39

1 6. Tribal Consultation:

2 a. When Section 106 consultation is required, consultation with federally recognized
3 Indian tribes and Native Hawaiian Organizations may be required. Not all projects
4 that require Section 106 review require consultation with Indian tribes.

5 Consultation with federally-recognized tribes is only required when a project
6 includes activities that have the potential to affect historic properties of religious
7 and cultural significance to tribes. These types of activities include:

8 i. ground disturbance (digging),

9 ii. new construction in undeveloped natural areas,

10 iii. introduction of incongruent visual, audible, or atmospheric changes,

11 iv. work on a building or structure with significant tribal association, or

12 v. transfer, lease or sale of historic properties of religious and cultural
13 significance.

14 b. When tribal consultation is required, the HUD reviewer will utilize the HUD
15 [Tribal Directory Assessment Tool](http://egis.hud.gov/tdat/Tribal.aspx) (<http://egis.hud.gov/tdat/Tribal.aspx>) during the
16 environmental review process to determine if the site is located in an area of tribal
17 significance. The tribal consultation requirement applies to properties *off* tribal
18 lands as well as on tribal lands. Properties with religious and cultural significance
19 to native people may include ancestral archaeological sites and natural areas
20 where traditional practices or ceremonies have been carried out as well as more
21 familiar historic properties. Some traditionally used places have very strong
22 religious associations, and it may be difficult or even inappropriate for native
23 people to talk about their significance. If this situation arises, hiring a qualified
24 professional with experience in tribal consultation may be required. The cost of
25 such an interpreter shall be paid by the borrower.

26
27 7. The Section 106 review must be completed before HUD approves and/or commits
28 funds to a project. Additional guidance on historic consultation is available on the
29 internet at: <https://www.onecpd.info/resource/2813/historic-preservation-basics/> and
30 <http://www.achp.gov/work106.html>.

1
2 8. [Can the cost of historic preservation mitigation be included in the proposed mortgage](#)
3 [loan?](#)

4
5 D. Floodplain Management and Flood Insurance (24 CFR 50.4(b)(1) and (2))

- 6 1. Applications for Firm Commitment are subject to regulations regarding floodplain
7 management found at 24 CFR Part 55 which implements Executive Order 11988
8 (Floodplain Management). The lender must utilize the Federal Emergency
9 Management Agency's best available data to comply with Floodplain Management
10 requirements, which may be Advisory Base Flood Elevations (ABFEs), Preliminary
11 Flood Insurance Rate Maps (P-FIRMs), or Flood Insurance Rate Maps (FIRMs). The
12 relevant Flood Insurance Rate Map (FIRM) may be found on line at:
13 www.msc.fema.gov . An on line resource for checking ABFEs can be found at:
14 <http://www.region2coastal.com/sandy/abfe>. If any part of the site or integral offsite
15 development is located within the 100-year floodplain (1% chance of annual flood,
16 known as the Special Flood Hazard Area) or within a 500-year floodplain (0.2%
17 chance of annual flood) for critical actions, according to the best available data, the
18 project must comply with HUD's floodplain management regulations.
19
- 20 2. An application for mortgage insurance shall not be approved for a property located in
21 (a) a floodway, (b) a coastal high hazard area (generally listed as "V" zones on Flood
22 Insurance Rate Maps), or (c) a FEMA identified special flood hazard area in which
23 the community has been suspended from or does not participate in the National Flood
24 Insurance Program. The terms "critical action," "coastal high hazard area,"
25 "floodway," and "functionally dependent use" are defined at 24 CFR 55.2. If a stream
26 coursing through a proposed site is designated as being in the 100-year floodplain
27 according to FEMA's best available data, but there is no designated floodway area (a
28 so-called "regulatory floodway"), development will be prohibited in the channel of
29 the stream.

30
31 Exceptions:

- 32 a. 24 CFR 55.12 lists categories of proposed actions for which the floodplain
33 management requirements in 24 CFR 55 are not applicable. The floodway and
34 coastal high hazard area prohibitions do not apply if only an incidental portion of
35 the project is in the 100-year floodplain, or for critical actions, the 500-year
36 floodplain, and certain conditions are met (see 24 CFR 55.12(c)(7)). HUD does
37 not consider improvements to be incidental.
- 38 b. Refinances of currently HUD-insured mortgages are exempt from the 24 CFR

1 Part 55 when the refinance will not result in any physical impacts or changes
2 except for routine maintenance under 24 CFR 50.19(b)(21). However, the flood
3 insurance requirements specified at 24 CFR 50.4(b)(1) are still applicable.

- 4
- 5 3. Projects that are converting from a non-residential to a residential use are considered
6 the same as “new construction” for floodplain management
7
- 8 4. New construction and substantial improvement, as defined at 24 CFR 55.2(b)(10), in
9 mapped 100-year floodplains is strongly discouraged. This flood buffer zone is
10 extended to the 500-year floodplain for proposed rehabilitation, refinancing, or new
11 construction for facilities housing or serving mobility-impaired individuals, a critical
12 use. Such sites in the applicable floodplain according to the best available data will
13 not be considered for mortgage insurance unless one of the following steps is taken:
14 a. A Conditional Letter of Map Amendment (CLOMA) or of Map Revision
15 (CLOMR) removing the entire site from the applicable floodplain has been
16 obtained from FEMA prior to submission of the pre-application or, in the absence
17 of a pre-application, prior to submission of the application for Firm Commitment.
18 If the applicant has a CLOMA or CLOMR, HUD approval for a Firm
19 Commitment will be conditioned on the borrower: (1) meeting the requirements
20 of the CLOMA or CLOMR; (2) obtaining a Final Letter of Map Amendment
21 (FLOMA) or MAP Revision (FLOMR) removing the entire site from the
22 applicable floodplain prior to Final Endorsement; and, (3) maintaining flood
23 insurance on any building during the construction period until the FLOMA or
24 FLOMR is issued; or
25 b. If Section 9.5.D.3.a does not apply, HUD must determine if there may be
26 extraordinary circumstances which lead to the conclusion that there are no
27 practicable alternatives to the project site being in the floodplain. In order to
28 make this determination, HUD must conduct an 8-step decision making process
29 which includes publishing two public notices and taking comments, as
30 summarized in 24 CFR 55.20. Prior to issuing the first public notice, HUD will
31 require detailed information about how the property will be altered and
32 improvements designed. This information includes the elevation of the property,
33 the elevation of the floodplain, and the location of life support systems.
34 i. Except in circumstances where it would not be practicable, in order to
35 minimize adverse impacts, the 8-step process shall require as a condition
36 of any project approval that a CLOMA or CLOMR be issued prior to
37 initial endorsement, a FLOMA or FLOMR be issued prior to Final
38 Endorsement, and flood insurance be maintained on any building during
39 the construction period until the issuance of the FLOMA or FLOMR.
40 ii. The 8-step process shall require that the lowest floor of new construction

- 1 be elevated at or above the Base Flood Elevation of the applicable
2 floodplain based on the best available FEMA data, plus one foot of
3 freeboard. However, in no event shall the lowest floor be below the Base
4 Flood Elevation on the current adopted Flood Insurance Rate Map.
- 5 iii. The 8-step process requires that all “critical actions” as defined in 24 CFR
6 55.2(b) (3) must comply with the requirements of 24 CFR 55.20(e).
- 7 iv. Instead of elevating non-residential or mixed use structures that are not
8 critical actions, the project may be designed and constructed such that
9 below the flood level, the structure is non-residential and flood proofed to
10 the level of the best available flood data plus one foot. Flood proofing
11 requires structures to be water tight with walls substantially impermeable
12 to the passage of water and with structural components having the
13 capability of resisting hydrostatic loads, hydrodynamic loads, the effects
14 of buoyancy, or higher standards required by the FEMA National Flood
15 Insurance Program as well as state and locally adopted codes.
- 16 v. The 8-step process shall be completed by HUD before issuance of the Firm
17 Commitment. HUD will develop the two notices, but the costs of
18 publication will be borne by the borrower.
- 19
- 20 5. For purchase or refinancing actions described in 24 CFR 55.12(a)(2) or repair,
21 rehabilitation, modernization or improvement actions described in 24 CFR
22 55.12(a)(3), an abbreviated process pursuant to 24 CFR 55.12(a) may be used by the
23 Hub or PC to determine their acceptability. Detailed information about the proposed
24 actions, and about any plans for mitigation, must be submitted an application phase.
25 HUD will evaluate risks and mitigation measures in making its decision. HUD
26 discourages these actions if the lowest floor and/or the life support facilities, or egress
27 and ingress of the existing building, are more than 12 inches below the 100-year
28 floodplain line. The abbreviated review process shall be completed by HUD before
29 issuance of the Firm Commitment.
- 30
- 31 6. Where a site does not appear to be located in the floodplain on official FEMA maps,
32 but shows evidence of flooding or has a history of flooding, HUD is not precluded
33 from qualitatively evaluating the acceptability of the site. Lenders will be required to
34 provide extensive data to aid HUD in evaluating previously flooded or floodplain site
- 35
- 36 7. Any building accepted that is located within a FEMA mapped special flood hazard
37 area is required to carry flood insurance under the National Flood Insurance Program
38 for the term of the loan, in an amount at least equal to the least of: the development
39 or project cost less estimated land value; the outstanding principal balance of the loan,

1 or the maximum available coverage. At the time of Application for Firm
2 Commitment, the lender must submit a completed Standard Flood Hazard
3 Determination Form with proof that the new mortgagor has a commitment for flood
4 insurance effective as of loan closing. All new and renewal leases must contain
5 acknowledgements signed by residents indicating that they have been advised that the
6 property is in a floodplain and flood insurance is available for their personal property
7 for sites within the 100-year floodplain and critical actions within the 500-year
8 floodplain.
9

10 8. The cost of floodplain mitigation may be included in the proposed mortgage loan.
11

12 E. Wetlands Protection (24 CFR 50.4(b)(3))

- 13 1. Applications for Firm Commitment for new construction are subject to regulations
14 regarding wetlands at 24 CFR Part 55, which implement Executive Order (EO) 11990
15 “Protection of Wetlands”. EO 11990 prohibits the development or disturbance of
16 wetlands and proposals impacting wetlands unless there is no practicable alternative
17 and the proposed action includes all practicable measures to minimize harm to the
18 wetland. Proposals impacting wetlands must be reviewed by HUD to determine
19 compliance with HUD-wetland protection policy. Wetlands are those identified on the
20 National Wetland Inventory maintained by the U.S. Fish and Wildlife Service.
- 21 2. The lender must provide extensive data in the Environmental Report to aid HUD in
22 evaluating wetland impacts and the lender should consult early with the field office
23 on any application for Firm Commitment on a site that impacts wetlands. HUD may
24 require that the lender submit a wetlands delineation performed by a qualified
25 professional to evaluate the direct and/or indirect wetland impacts of the project.
26 Appropriate and practicable compensatory mitigation is recommended for
27 unavoidable adverse impacts to more than one acre of wetlands. Compensatory
28 mitigation includes, but is not limited to: permittee-responsible mitigation, mitigation
29 banking, in-lieu fee mitigation, the use of preservation easements or protective
30 covenants, and any form of mitigation promoted by state or Federal agencies.
- 31 3. New construction projects on land listed in the inventory will be considered only
32 after HUD conducts an 8-step decision-making process which is the same as used for
33 the flood plain process and includes consultation, issuing two public notices and
34 taking public comment. Wetlands under local or state jurisdiction are subject to state

- 1 or local review as appropriate. However, compliance with state or local requirements
2 is not a substitute for the eight-step process.
- 3 4. Only in rare cases will rehabilitation, purchase and refinancing proposals be permitted
4 to involve wetlands impacts.
- 5 5. Wetlands could impact the value of the site and may be considered an unusual site
6 condition (in which case the cost of mitigation would be deducted from the warranted
7 price of the land “as improved”.)
- 8 F. Endangered Species (24 CFR 50.4(e))
- 9 1. Under Section 7 of the Endangered Species Act, HUD must consult with the U.S.
10 Fish and Wildlife Service or the National Marine Fisheries Service (the Services)
11 whenever a proposal may affect an endangered or threatened species or its habitat. A
12 required consultation should be assumed for any site within the critical habitat (as
13 defined in 50 CFR Part 226) of a listed species.
- 14 2. In areas where impacts on endangered or threatened species are a concern, all
15 appropriate information regarding possible impacts of the project should be provided
16 to HUD as early as possible. The lender should review published information,
17 including but not limited to information on the Services websites regarding the
18 possible presence and associated critical habitat of any listed species in the vicinity of
19 its proposal and provide HUD with the results of its research. Furthermore, if a
20 lender believes that its proposal is in an area of potential impacts on a listed species or
21 its critical habitat, it should discuss any possible associated impacts caused by its
22 proposal in its submission to HUD. The lender should not contact the Services
23 directly.
- 24 3. If the project activity could affect an endangered/threatened species or its habitat,
25 HUD must make a determination of effect. HUD must seek concurrence of the
26 Services on any “may affect, not likely to affect” determination and associated
27 mitigation measures. HUD must initiate formal consultation under Section 7 for a
28 “may affect, likely to adversely affect” determination. The lender may be required to
29 prepare special studies such as habitat assessments, surveys or biological assessments.

- 1 4. Consultation under Section 7 may result in more stringent conservation measures
2 than would otherwise be imposed. The Regional Center Regional Office can advise
3 the lender where information on endangered species may be obtained.
- 4 5. The cost of mitigation to accommodate endangered species would likely be deducted
5 from the warranted price of the land as an unusual site condition.

6 G. Noise (24 CFR Part 51, Subpart B)

- 7 1. HUD standards regarding the acceptability of noise impacts on residential property
8 are found at 24 CFR Part 51 Subpart B, which standards must be met for new
9 construction and conversion from nonresidential to residential projects. Where
10 threshold criteria are met or exceeded, a noise analysis utilizing the methodology in
11 HUD's Noise Guidebook (HUD- 953-CPD) will be performed by HUD as part of
12 HUD's NEPA environmental assessment. The Regional Center Regional Office
13 should be consulted prior to attempting to design mitigation measures.
- 14 2. New construction or conversions of existing structures to residential housing in the
15 Unacceptable Noise Zone, where outdoor noise levels are above 75 dB, are
16 prohibited. If the Regional Center Regional Office wants to consider such a proposal,
17 it must:
 - 18 a. Prepare an Environmental Impact Statement (EIS). If the Regional Center
19 Regional Office believes that the proposal is acceptable based on the EIS, it must
20 then obtain project approval, including approval of noise mitigation measures,
21 from the Assistant Secretary for Community Planning and Development; or
 - 22 b. If the Regional Center Regional Office determines that noise is the only
23 environmental issue and no outdoor noise sensitive activity will take place on the
24 site, it may request a waiver of the EIS Requirement by the Assistant Secretary
25 for Community Planning and Development.
- 26 3. Noise analysis and attenuation of refinance applications is required by 24 CFR Part
27 51 if the repairs or renovation will increase residential densities, convert the building
28 to residential or make a vacant building habitable. For rehabilitation projects that do
29 not require noise analysis and attenuation, HUD will encourage appropriate noise
30 attenuation measures for inclusion in the property alteration. For all other projects,

1 noise exposure by itself will not result in the rejection of existing properties for
2 insurance, but will be considered as a marketability factor.

3 H. Explosive/Flammable Hazards (24 CFR Part 51 Subpart C)

4 HUD will not insure a property where structures and residents will be exposed to
5 unacceptable risks posed by proximity to explosive or flammable hazards. This means
6 that for new construction projects, and rehabilitation projects where unit density is
7 increased or where there is a conversion from non-residential to residential or where a
8 vacant building is made habitable, there must be an Acceptable Separation Distance
9 (ASD) away from aboveground storage facilities with explosive or flammable material
10 contents and similar industrial facilities. HUD standards regarding proximity to explosive
11 or flammable hazards are found at 24 CFR Part 51 Subpart C. Analysis of sites near or in
12 the vicinity of these types of facilities must be performed by HUD as part of the NEPA
13 environmental assessment in accordance with the HUD guidebook: “Sitting of HUD
14 Assisted Projects Near Hazardous Facilities (HUD-1060-CPD)”. If a plan is agreed upon
15 with HUD before the invitation letter, these hazards may be mitigated during the
16 construction period, if the work can be done on the subject property. For projects to be
17 purchased or refinanced, HUD will substantively evaluate the risks associated with
18 proximity to hazardous facilities.

19 I. Coastal Barriers (24 CFR 50.4(c)(1))

20 Under the Coastal Barriers Resources Act, HUD is prohibited from insuring a project
21 located within designated coastal barriers of the Atlantic Ocean, Gulf of Mexico, or the
22 Great Lakes, known as Coastal Barrier Resource System (CBRS) units and shown on
23 associated Fish and Wildlife Service maps. A project located within a CBRS unit or that
24 includes a facility (such as a water main) to a CBRS unit will not be eligible for
25 application processing.

26 J. Coastal Zone Management (24 CFR 50.4(c)(2))

27 Projects located within a state’s coastal management zone must be determined to be
28 consistent with the approved state Coastal Zone Management program. In many states,
29 HUD will require a letter from the State Coastal Zone Management Agency confirming
30 consistency with the approved program. Mortgagees should be aware of the extent of
31 coastal management zones in coastal states and contact the field office early when
32 examining a proposal in a coastal zone.

1 K. Sole Source Aquifers (24 CFR 50.4(d))

2 Projects utilizing municipal water and sewer, and with appropriate local drainage and
3 runoff approval, require no review for sole source aquifers. An aquifer is an underground
4 body of water usually kept in place by rock, gravel, or sand. New construction and some
5 rehabilitation projects located within the boundaries of the recharge area of a designated
6 sole source aquifer must be reviewed by EPA for their effect on the sole source aquifer.
7 HUD offices will identify the local, state or Federal agency with maps of sole source
8 aquifers.

9 L. Runway Clear Zone, Runway Protection Zones, Clear Zone, or Accident Potential Zone
10 (24 CFR Part 51 Subpart D)

- 11 1. HUD standards regarding the acceptability of property located in Runway Clear
12 Zones (also known as Runway Protection Zones), Clear Zones, and Accident
13 Potential Zones are found at 24 CFR Part 51 Subpart D. An Accident Potential Zone
14 is an area at military airfields that is beyond the Clear Zone.
- 15 2. Construction or major rehabilitation of any property located within a Clear Zone is
16 prohibited. Acquisition, refinance and minor rehabilitation of projects within Clear
17 Zones are allowed with some restrictions. HUD must determine that projects located
18 in Accident Potential Zones are generally consistent with Department of Defense land
19 use compatibility guidelines for Accident Potential Zones.
- 20 3. HUD, as part of its environmental review for an existing property, shall advise the
21 lender who will advise the mortgagor purchasing the property that the property is in a
22 Runway Clear Zone, Clear Zone, and what the implications of such a location are.
23 The buyer must sign a statement acknowledging receipt of this information. HUD
24 may reject applications for existing properties within a Runway Clear Zone or Clear
25 Zone because of the possibility that the property may be acquired at that later date by
26 the airport operator.

27 M. Environmental Justice (24 CFR 50.4(l))

28 HUD will determine whether EO 12898, Federal Actions to Address Environmental
29 Justice in Minority Populations and Low Income Populations, is applicable to the
30 project. This EO requires that federal actions not result in disproportionately high and
31 adverse health or environmental effects on minority or low-income populations. When a
32 project impacts a minority or low-income population, or when siting of a project raises

1 questions of discrimination, HUD will perform the necessary analysis before determining
2 the acceptability of the project. A project that will receive a Low Income Housing Tax
3 Credit is a clear example of when environmental justice concerns should be
4 evaluated. HUD will advise the lender of any Environmental Justice concerns including
5 recommendations on their resolution. In most cases the preferred resolution would be to
6 modify the project to eliminate or at least reduce the adverse effects, when feasible.

7 N. Other Federal or State Laws (Form HUD-4128, Part A, No. 24)

- 8 1. Applications for Firm Commitment are subject to provisions of other Federal
9 authorities which seldom require action on the part of HUD, including the Wild and
10 Scenic Rivers Act, Farmland Protection Policy Act, and the Clean Air Act. Certain
11 State regulations also implement air quality requirements. HUD will advise the
12 lender if any actions under these or other Federal or State authorities are required.
- 13 2. HUD may require mitigation of a variety of additional nuisances and hazards on the
14 property which would affect the health and safety of residents and the security of the
15 collateral.

16 O. Commonly found or Observed Additional Nuisances and Hazards (applicable to all
17 transaction types except those categorically excluded from all environmental review, as
18 discussed at 9.1A.5 above).

- 19 1. All parts of any structure must be at least 10 feet from the outer boundary of the
20 easement for any high pressure gas or liquid petroleum transportation pipeline.
- 21 2. No structure may be located within the easement of any overhead high voltage
22 transmission line. Structures must also be located outside the engineered fall distance
23 of any support structure for high voltage transmission lines, radio antennae, satellite
24 towers, cellular towers, etc. This does not apply to local service electric lines and
25 poles.
- 26 3. HUD requirements for oil or gas wells, sour gas wells and slush pits:
- 27 a. Operating or planned drilling site: No residential structures may be within 300
28 feet of the boundary of the drilling site.
- 29 b. Operating well: No residential structures may be within 75 feet of an operating
30 well, unless the following mitigating measures are taken:
- 31 i. Controls on nuisances;

- 1 ii. Controls on noise caused by pumping; and
- 2 iii. Spill controls to reduce risk of contamination.
- 3 c. Abandoned wells
- 4 i. Confirmation by the State government that the well is safely and
- 5 permanently abandoned and no residential structures are within 10 feet must
- 6 be obtained.
- 7 ii. If there is no confirmation letter, no residential structures may be located
- 8 within 300 feet of an abandoned well.
- 9 d. Sour gas (hydrogen sulfide bi-product) wells: Separation distance must be
- 10 determined by a Petroleum Engineer, with concurrence by State government.
- 11 e. Slush pits (used for drilling mud mixes for well lubrication):
- 12 i. If on-site, hazards analysis is required to be performed pursuant to Section
- 13 9.3 above. Mitigation must include, but not necessarily be limited to,
- 14 removal of all drilling mud from the site and backfilling with clean
- 15 compacted material.
- 16 ii. If offsite, hazards analysis must be performed pursuant to Section 9.3.
- 17 4. If any part of a site is to be developed on filled ground, HUD may require that all
- 18 grading be properly controlled to prevent differential earth movement, sliding,
- 19 erosion, and/or other occurrences which might damage dwellings, streets or other
- 20 improvements (Form HUD-4128, Part B, No. 27).
- 21 5. Hubs/PCs may adopt additional requirements to address unique local concerns, but, if
- 22 any local requirement is mandated, the Regional Center Regional Office must inform
- 23 the Deputy Assistant Secretary for Multifamily Housing and the HUD Headquarters
- 24 Housing Environmental Clearance Officer of the requirement and its rationale.

Chapter 10 Management Analysis

10.1 Introduction

A. Management agents that operate insured multifamily properties play a key role in providing quality housing. While it is the ultimate responsibility of the project owner/mortgagor to select and oversee the management agent of an insured property, the establishment of an effective relationship among HUD, the owner, and the management agent is critical to the success of the property over the life of the mortgage. The management agreement and related documents must be submitted with the Firm Commitment application or can be submitted at the pre-application stage if the management agent has been identified at that stage.

B. The lender must review whether the proposed management agent demonstrates the qualifications, capability and experience to assure that the property will be managed in a prudent, efficient, and cost-effective manner and in accordance with all HUD requirements. Documentation submitted by the lender in support of the choice of management agent must demonstrate that the agent:

1. Is eligible for approval and is in good standing with HUD;
2. Demonstrates effective management experience and acceptable operating procedures commensurate with the type of project;
3. Has adequate fidelity bond coverage;
4. Is in compliance with all state and local laws, regulations and requirements; and
5. Is able to positively communicate and cooperate with legitimate resident associations.

10.2 Exhibits Required for Firm Commitment

A. Exhibits

1. Form HUD-2530 Previous Participation (paper) or Active Partners Performance System (APPS). Participants are permitted to submit to HUD their 2530 submission package for electronic review via Active Partners Performance System (“APPS”) or by paper form HUD-2530 as early as the pre-application processing stage for all

- 1 principals and affiliates of the management agent. See Section 8.2.A.4 for details
2 when submitting a pre-application.
- 3 2. HUD-9832, Management Entity Profile for the Agent. This form provides detailed
4 information regarding the organization, operation, and experience of the proposed
5 management agent. The management plan should provide a narrative overview and
6 should include any pertinent leasing or management strategies that are not covered in
7 Form HUD-9832.
- 8 3. HUD-9839 A, B, or C - Owner's/Management Agent's Certification, as appropriate.
9 In this document, the agent and owner must certify that HUD requirements and
10 contract obligations will be complied with, and that an acceptable Management
11 Agreement will be executed. The agent and owner must certify that no payments
12 have been made to the owner in return for awarding the management contract to the
13 agent, and that no such payments will be made in the future.
- 14 4. Proposed Staffing for the Project. Information is required regarding the job-titles,
15 duties, and salaries of all employees of the management agent who will work at the
16 project which will be reviewed to determine if the number, salaries, and duties of the
17 proposed staff is reasonable and adequate for the size and type of the proposed
18 project. If there is a non-customary situation or arrangement, resulting in the need for
19 more or less staff than usual, an explanation of this must be provided.
- 20 5. Resident Complaints Resolution Procedure. Provide a description of the procedure used
21 by the agent to resolve resident complaints, as well as examples of how the system has
22 been implemented.
- 23 6. Management Agreement, if Applicable. Projects with identity-of-interest
24 management agents or independent fee management agents must execute a
25 Management Agreement. An agreement is recommended, but not required, for
26 owner-managed projects or projects managed by a project administrator.
- 27 7. Marketing, Leasing, and (if applicable) Relocation Plan.
- 28 a. All projects which require absorption of units at economic rents to achieve break-
29 even occupancy must submit a detailed marketing and leasing plan and budget
30 that has been reviewed and confirmed by the proposed management agent. The
31 plan must discuss when marketing efforts will begin, when the leasing office and
32 model units will be opened, how the leasing office will be staffed, and the
33 project's marketing and advertising strategy. The plan must address timing of the
34 construction progress schedule with respect to egress and ingress into the project,
35 landscaping, and access to amenities. These items are in addition to those
36 required by the Affirmative Fair Housing Marketing Plan.

- 1 b. For substantial rehabilitation projects involving temporary relocation or
2 displacement of existing residents, the plan must address details of timing,
3 funding and management of the relocation process.
- 4 c. The lender's underwriter, the field office team leader and the Asset Management
5 staff should review the marketing plan. Although not required, the lender may
6 retain a third party property management or leasing consultant to review such
7 plans for large or complex deals or where the proposed property manager is not
8 fully experienced.
- 9 8. Affirmative Fair Housing Marketing Plan, Form HUD-935.2A, if applicable. See
10 Section 10.8 for more detail.
- 11 9. Additional Information Required by the Field Office. It may be necessary to provide
12 the field office with additional information so that a determination of the acceptability
13 of the proposed management agent can be made.

14 **10.3 Lender Review of Management Documents**

15 As part of the Firm Commitment application package, the lender must provide documentation to
16 demonstrate the acceptability of the proposed management agent, with the Management Entity
17 Profile of particular importance. The lender must review the qualifications of the proposed agent
18 to assess its ability to manage the project effectively and in compliance with HUD requirements,
19 and must consider each of the following factors:

- 21 A. Past and Current Management
- 22 1. The lender must review the proposed agent's past experience and current
23 performance with respect to the following indicators:
 - 24 a. Experience with projects similar in size and configuration to the subject
 - 25 b. Billing practices
 - 26 c. Controlling operating expenses
 - 27 d. Vacancy rates
 - 28 e. Resident turnover
 - 29 f. Rent collection and accounts receivable
 - 30 g. Physical security

- 1 h. Physical condition and maintenance
- 2 i. Financial reporting
- 3 j. Resident relations
- 4 k. Resident income certification, record keeping and reporting if an affordable or
- 5 subsidized project
- 6 2. If problems are identified with any of these indicators, the lender must assess whether
- 7 the agent has adequately improved its procedures to prevent the recurrence of such
- 8 problems or whether management initiatives by the agent and owner are sufficient to
- 9 correct the problems and their causes.
- 10 B. Ability to Manage Troubled Projects.
- 11 If the property has physical, financial or social problems that require special expertise or
- 12 skills to manage effectively, the lender must determine whether the agent has the
- 13 necessary skills and expertise and whether the agent's proposed remedies for these
- 14 problems are appropriate. Agents proposed for these projects should have prior
- 15 experience successfully addressing similar issues.
- 16 C. Management Qualifications.
- 17 The proposed management agent should have at least one senior staff person who drafts
- 18 the agent's policies and supervises project operations with the following qualifications:
- 19 1. A professional designation in housing management from a national organization that
- 20 provides such accreditation, and
- 21 2. A minimum of 5 years experience in directing and overseeing the management of
- 22 multifamily projects serving a similar resident clientele.
- 23 The lender may accept a proposed agent without the experience requirements listed in this
- 24 section if the agent is satisfactorily managing other insured or subsidized projects.
- 25 D. Past Performance with Identity-of-Interest Contractors.
- 26 If the management agent purchases goods or services from identity-of-interest companies
- 27 and has previously managed insured projects, the lender must assess the agent's past use
- 28 of such companies and whether this use resulted in costs to the project that exceed the
- 29 prices paid in arms-length transactions. The review should especially consider:
- 30 1. Goods and services purchased through any "pass-through" arrangements described in
- 31 item 11(b) of the Management Entity Profile.
- 32 2. Evidence that the agent has compared prices and that the use of any identity-of-
- 33 interest companies or pass-through arrangements has been more advantageous to the
- 34 project than purchasing through arms-length transactions would have been.

10.5 Review of Previous Participation

A. APPS was developed to automate the submission and review of the Previous Participation Certification Process (paper_Form HUD-2530). If the management agent submits an electronic 2530 in APPS, select Property submission reason as: "Application for Mortgage Insurance" with role as "Management Agent." Submission of the electronic 2530 requires that all participants must register in the Business Partner Registration System (BPRS).

B. While reviewing 2530, HUD staff will check for all non-compliance issues based on previous participation records and other relevant information in HUD database or from other sources. In addition:

1. Notwithstanding the issuance of the Commitment, previous participation approval of the management agent must be obtained prior to and as a condition of Initial Endorsement.
2. Firm Commitments may only be conditionally issued when the commitment processing is otherwise completed and all principals of the management agent are determined to be acceptable.

10.6 Bonding Requirements for Agents

The lender must determine that the agent has adequate bonding to provide a basic level of protection for the multifamily project assets.

A. The management agent must certify in the Management Certification that it carries fidelity bond or employee dishonesty coverage for:

1. All principals of the management entity, and
2. All persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts, and records.

B. The fidelity bond or coverage must name the mortgagee and HUD as additional loss payees.

C. Coverage may be through one or more bonds, and one bond may cover more than one project, including projects whose mortgages are not insured or held by HUD. The

1 agent's principals and supervisory and front-line staff may be covered under the same
2 bond.

3 D. Each project must be bonded for at least the value of two months' gross potential income
4 for the project. If a bond covers more than one project, this minimum must be computed
5 using the project with the highest gross potential income.

6 **10.7 Management Agreement Requirements**

7 A. Applicability. Projects with identity-of-interest agents or independent fee agents must
8 execute a Management Agreement. An Agreement is recommended, but not required, for
9 owner-managed projects or projects managed by a project administrator.

10 B. Required contents. The owner and agent may negotiate their own form of agreement
11 provided that it contains language which meets the following requirements:

12 1. Scope of services. All management agreements must describe the services the agent
13 is responsible for performing and for which the management fee will be paid.

14 2. Required clauses. All agreements must provide that:

15 a. Management fees will be computed and paid according to HUD requirements.

16 b. HUD may require the owner to terminate the agreement:

17 (1) Immediately if a default occurs under the Mortgage, Note, Regulatory
18 Agreement, or Rental Assistance Contract that is attributable to the actions
19 of the management agent;

20 (2) Upon 30 days written notice, for failure to comply with the provisions of
21 the Management Certification or for other good cause; or

22 (3) When HUD takes over the property as Mortgagee in Possession.

23 NOTE: The management agreement must always give the owner the
24 ability to terminate the contract for cause, with no more than a 30 day
25 notice period.

26 c. If HUD terminates the agreement pursuant to its authority under the loan
27 documents (HUD-92466M, Regulatory Agreement provision 21), the owner will
28 promptly make arrangements for obtaining an alternative management agent that
29 is satisfactory to HUD.

30 d. HUD's rights and requirements will prevail in the event of any conflicts with the
31 terms of the management agreement.

- 1 e. The management agent must turn over to the owner all of the project’s cash,
2 accounts, deposits, investments, and records immediately, but in no event no
3 longer than 30 days after the date the management agreement is terminated.
- 4 3. Prohibited “hold harmless” clause. Management Agreements cannot exempt the
5 agent from liability for damages, injuries and losses. This includes all “hold
6 harmless” provisions, such as parties holding each other harmless except in the case
7 of willful misconduct/ gross negligence. Allowing a management agent to be held
8 harmless for all breaches of the standard of care less than willful misconduct/ gross
9 negligent is against HUD policy (such an exemption would allow a management
10 agent to be held harmless for negligence).”
- 11 C. Length/term of the Agreement. The length/term of the Management Agreement will be
12 negotiated between the owner and the management agent. However, HUD will require a
13 minimum one-year term. HUD may also impose a maximum term on the Management
14 Agreement if the agent was approved by HUD on a conditional basis.
- 15 1. The Agreement may provide for a fixed term or an open-ended term (e.g.,
16 automatically renewable or “to remain in effect until cancelled by HUD, the owner,
17 or the agent”).
- 18 2. If the length /term of the Agreement changes before initial endorsement, the
19 owner/agent must submit a new Management Certification.
- 20 D. Management Fee: The Agreement must include all specifics of the management agent
21 compensation and how the management fee will be calculated, including any incentive
22 management fees to be paid from surplus cash. HUD will review the fee for adequacy
23 and reasonableness for a project of the size and complexity as what is proposed. The
24 management fee must be equivalent to, and be no less than, a market rate fee that would
25 be charged by a replacement, third party management agent, if the replacement agent
26 were to assume responsibility for management of the property.

27 **10.8 Approval of Proposed Management Agent**

- 28 A. The lender will recommend approval to the Hub Satellite office of the proposed agent if
29 the agent has demonstrated capacity to effectively manage the property within HUD
30 requirements, the management agent has shown adequate fidelity bond coverage and the
31 Previous Participation Certification is approved. In some instances, the lender may find
32 it necessary to recommend conditional approval if there are areas of the agent’s
33 procedures that are considered weak or that need to be changed. All conditional
34 approvals will be discussed with the proposed agent and any agreements/conditions that

1 are imposed will be shown both in the letter approving the agent, and in the Firm
2 Commitment.

3 B. The lender must provide a report regarding its review and recommendation which
4 includes the following information:

5 1. Name of the proposed management agent.

6 2. Composition of the proposed management agent.

7 3. Narrative of the agent's experience and capacity to operate the subject property, with
8 particular emphasis on its past experience and capacity to manage affordable or
9 subsidized properties, if applicable.

10 4. Demonstration that adequate fidelity bond coverage is in effect and that the proposed
11 management agreement meets HUD's requirements.

12 5. A recommendation to approve the proposed management agent.

13 C. The Hub/Satellite office may disapprove a proposed management agent based on the
14 decision of the Review Committee to deny or withhold approval for the proposed agent's
15 participation. The Committee may base its disapproval on the lack of the management
16 agent's capacity to effectively manage the project within HUD requirements and to
17 adequately meet the requirements of this Chapter. To proceed with a Firm Commitment
18 review, the owner must then propose an alternative management agent (and supply all
19 required documentation). The owner may appeal the decision of the Previous
20 Participation Committee under 24 CFR, Part 200.241.

21 D. HUD will review the lender's report and the management entity profile and make the
22 final determination to accept or reject the proposed management agent.

24 **10.9 Affirmative Fair Housing Marketing**

25
26 The Affirmative Fair Housing Marketing Requirements (24 CFR 200.600, Subpart M) apply to
27 all insured new construction and substantial rehabilitation projects of 5 or more units. Each
28 applicant for insurance must submit an Affirmative Fair Housing Marketing Plan or Form HUD-
29 935.2A. The plan must describe an affirmative program to attract residents regardless of race,
30 color, religion, sex, disability, familial status, sexual orientation or national origin to the housing
31 for initial rental. The affirmative advertising program shall use majority and minority media and
32 shall identify those groups within the eligible population that are considered least likely to apply
33 for the housing without special outreach. The plan should include information on the applicant's

1 nondiscriminatory hiring policy, its training program on nondiscrimination for its rental staff,
2 and the display of the Department's Equal Housing Opportunity logo type and slogan. HUD
3 must review and approve the Plan prior to the issuance of the Firm Commitment.

4 Applications under Section 223(f), while covered by the nondiscrimination provisions of the Fair
5 Housing Act and Executive Order 11063, are exempt from the submission of a written plan.

6 However, a Section 223(f) applicant is required to maintain records of its affirmative marketing
7 efforts.

8

9 **10.10 Management Agent Responsibility for Escrow**
10 **Administration**

11 Management Agents must cooperate with the lender and with the Hub/Satellite office staff in
12 administration of the Initial Operating Deficit (IOD) escrow, including any disbursements
13 permitted and the release of any escrow balance remaining. The terms and procedures for
14 release of the IOD are addressed in Section 12.15.E.

15 Management Agents must cooperate with the lender and with the Hub/Satellite office staff in
16 administration of the Reserve for Replacements account (per the reserve schedule and deposit
17 requirements included in the Firm Commitment) and in the requirement to obtain a new Project
18 Capital Needs Assessment (PCNA) every 10 years during the loan term. See Appendix 5 for
19 more details on PCNAs.

20

Chapter 11

Lender Underwriting, HUD Review and Closing Matters

11.1 General

The MAP program delegates due diligence and underwriting responsibility to MAP approved Underwriters and lenders. The MAP approved Underwriter is expected to be completely familiar with the contents of the MAP Guide, have demonstrated experience and mastery of commercial lending practices and real estate finance, and have a working knowledge of HUD regulatory and statutory authority.

HUD retains commitment authority and responsibility for final determination of acceptable risk to the insurance fund, as well certain technical and compliance responsibilities. This in no way relieves the MAP Lender from responsibility for their underwriting and programmatic compliance.

The basic function of a MAP approved Underwriter is to objectively evaluate the following factors in making a credit approval recommendation:

- Character, creditworthiness, competence, and capacity of the borrower and development team members;
- Cash flow sufficient to service the proposed loan;
- Collateral quality, including valuation, physical condition, environmental factors and location;
- Capital structure, including all proposed indebtedness and equity;
- Cash available to close, given the total mortgageable and non-mortgageable costs of the transaction; and
- Compliance with HUD program and processing requirements.

1
2 If a transaction recommended by a lender is properly underwritten and processed, and is
3 complete and technically compliant, HUD's role is to review the application and the lender
4 can assume a timely determination as submitted.

5 If the application fails to identify material underwriting risks and mitigants, or has material
6 processing or compliance deficiencies, HUD will reject the application, re-underwrite it and
7 approve with conditions, or return the application to the lender for modifications to address
8 deficiencies.

9 The responsibilities of MAP lender and HUD underwriters are addressed in Chapter 4
10 (Processing) and in this chapter.

11 12 13 **11.2 Lender Underwriting**

14
15 A. The lender is responsible for assigning a MAP approved Underwriter for the Pre-
16 application or Firm Commitment. The MAP approved Underwriter is responsible for the
17 selection and performance of the third party professionals (both the firms and
18 individuals). The Construction Loan Administrator must be approved prior to the Firm
19 Commitment stage.

20
21 The lender's MAP Approved Underwriter is responsible for oversight and performance of the
22 following tasks:

- 23 11. Data collection;
- 24 12. Due diligence, including selection and management of their third party consultants;
- 25 13. Loan Processing;
- 26 14. Mortgage Credit review;
- 27 15. Underwriting;
- 28 16. Obtain internal loan approval (from the lender's loan committee or other process);
- 29 17. Submission of the loan application and fee to the appropriate Regional Center or
30 Satellite Office;
- 31 18. Responding to HUD deficiency letters and requests for information;
- 32 19. Follow-up to get the loan to closing;

1 20. Coordination with construction loan administration, cost certification, and servicing.

2 B. Pre-application. The lender's underwriter must determine that the submission meets the
3 requirements of this Guide and represents an acceptable risk to the insurance fund. The
4 pre-application submission to the field office must include a Standardized Underwriter
5 Narrative, and additional information and narrative attachments, which provides:

6 1. A summary of the relevant data and quantitative analysis.

7 2. Strengths, weaknesses, risks and mitigants.

8 3. A summary of programmatic eligibility and technical factors considered.

9 4. A description of the proposed project and the surrounding market conditions,
10 including demand, extent of competition, vacancy rates, market absorption, details
11 about features of the proposal (e.g., zoning, unusual site conditions, environmental)
12 which may present potential problems, and any other information that would be
13 useful to analyze the proposal.

14 5. A description of the project sponsor (plus general contractor and management agent,
15 if known), their qualifications, the identification of principals and a preliminary
16 mortgage credit and creditworthiness review.

17 6. Explanations for any differences between the Underwriting conclusions and the third
18 party due diligence.

19 7. A list of proposed in-house and third party reviewers of the application and their
20 qualifications.

21 Further details on the required content of the Standardized Underwriter's Narrative and
22 the materials to be included in the pre-application can be found in this Guide and
23 appendices.

24 C. Firm Commitment Application: The lender's underwriter must review the in-house and
25 third party reports, ensure the processing of the loan is in accordance with the
26 requirements of this Guide and determine that the loan recommendation represents an
27 acceptable risk and is financially sound. The underwriter must document any changes
28 made to the technical reports and must submit an updated, signed Standardized
29 Underwriter's Narrative describing all relevant aspects of the mortgage transaction
30 including a full discussion of the following:

31 1. Characteristics of the proposed mortgage that make it financially sound or an
32 acceptable risk, with the reasons why the lender recommends the loan.

33 2. All significant risk factors and risk mitigants.

34 3. Changes in the project from the pre-application stage including changes in
35 sponsorship, proposed development team and lender reviewers.

- 1 4. Evaluation of the mortgage credit and financial capacity of the principals of the
2 borrower and its ability to repay the loan.
- 3 5. Evaluation of the financial and technical capacity of the general contractor to
4 build/rehabilitate the project.
- 5 6. Property financial analysis (both actual operating history and projected trends).
- 6 7. Property physical description.
- 7 8. History of borrower's involvement including their equity investment in the property,
8 and if applicable, any previous engagements to obtain FHA financing for the
9 property.
- 10 9. Analysis of market, rents, expenses and estimated rent-up and operating deficit.
- 11 10. Adequacy of the proposed Reserve for Replacement.
- 12 11. Documentation of any changes the underwriter made to the appraisal/technical reports
13 with justification.
- 14 12. Requests for any waivers of Guide requirements with supporting documentation.
- 15 13. Certifications from the individual reviewers (see Section 11.2M).
- 16 Further details on the required content of the Standardized Underwriter's Narrative and
17 the materials to be included in the Firm Commitment application can be found in this
18 Guide and appendices.
- 19 D. The MAP Underwriter should perform the site visit for new construction properties and
20 for existing properties an on-site lease audit and physical inspection representing a
21 sample of each unit type. Alternatively, an analyst, underwriter trainee, or different MAP
22 approved underwriter acting under the direction of the underwriter (i.e., one that does not
23 report to the originator) may perform the site visit and physical inspection of the units.
24 The underwriter or trainee who conducts the inspection must be identified in the
25 narrative. Typically, the leases that are audited will be the same as the units that are
26 inspected, as follows:
 - 27 1. For projects 50 units or less: Inspect at least 1 of each unit type, to include a
28 representative sample of 10% of the units.
 - 29 2. For projects between 51 and 250 units: Inspect at least 1 of each unit type, to include
30 a representative sample of 10 units plus 5% of the total number of units greater than
31 50.
 - 32 3. For projects greater than 250 units: Inspect at least 1 of each unit type, to include a
33 representative sample of 15 units, plus 2% of the total number of units greater than
34 250, for a maximum of 50 units.

- 1 4. The terms of the leases must be compared to the rent roll, verifying the unit number,
2 resident name, lease commencement date, expiration date, concessions, if any, and
3 monthly rent, and must confirm that this data is consistent with the assumptions used
4 in the underwriting analysis.
- 5 5. Any inconsistencies or conflicts between the leases, rent roll and the underwritten
6 revenue assumptions must be fully investigated and explained. The scope and results
7 of the lease audit review must be discussed in the Underwriter's Narrative. The
8 underwriter should retain a copy of the individual leases reviewed in their working
9 papers, which may be subject to audit but should not be included in the Firm
10 Commitment application submission.
- 11 E. The underwriter is responsible for the review and reconciliation of the third party reports
12 and the results of the mortgage credit review and other due diligence.
- 13 F. Lender Due Diligence Certification: With each Firm Commitment package, the lender
14 must submit a letter signed by the MAP approved underwriter which certifies that:
- 15 1. The lender has reviewed all in-house and third party forms/reports/reviews;
16 2. The preparer of the forms/reports/reviews is qualified as required by this Guide and
17 has any of the required insurance coverage(s);
18 3. The forms/reports/reviews were prepared in the manner required by the Guide are
19 complete and accurate;
20 4. The identity of staff and contractors who contributed to the underwriting presentation
21 and their role, and
22 4. The proposed loan represents an acceptable risk to the Department and is financially
23 sound, based upon the lender's review and analysis, and that the application complies
24 with all HUD statutory, regulatory, guidebook and administrative requirements.
- 25 The letter must include the following certification and language:
26 I am employed full time by the MAP Lender and have no other side deals,
27 agreements, or financial considerations in connection with this transaction.
28
- 29 G. Third party report Certifications. The following Certification must be included by the
30 lenders third party reports:
- 31 I understand that my (appraisal, market study or architectural, cost, environmental, or
32 other specialized report) will be used by _____ (name of MAP Lender) to document to
33 the U.S. Department of Housing and Urban Development that the MAP Lender's

1 application for FHA multifamily mortgage insurance was prepared and reviewed in
2 accordance with HUD requirements. I certify that my review was in accordance with the
3 HUD requirements applicable on the date of my review and that I have no financial
4 interest or family relationship with the officers, directors, stockholders, or partners of the
5 lender or affiliated entities, Borrower or affiliated entities, the general contractor, any
6 subcontractors, the buyer or seller of the proposed property or engage in any business that
7 might present a conflict of interest.

8 H. Both the underwriter and third party certifications must contain the following language:

9
10 _____ Signature

11 Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or
12 uses a document containing any false, fictitious, or fraudulent statement or entry, in any
13 manner in the jurisdiction of any department or agency of the United States, shall be fined not
14 more than \$10,000 or imprisoned for not more than five years or both.

15 G. HUD Forms Submission. The lender must submit a Standardized Underwriting
16 Narrative, “wheelbarrow” data submission and a HUD-92013. The HUD-92264 and
17 HUD-92264-A forms are still required at this time; no signature by the lender or their
18 third parties is required. The lender must certify that all parties preparing forms, reports
19 or reviews are qualified as required by the Guide.

20 **11.3 HUD Regional Center or Satellite Office Underwriting Review**

21 A. Under the direction of the MF Regional Center Director and other appropriate
22 managers, the HUD underwriter is responsible for coordinating with technical support
23 and other HUD staff, and the oversight and performance of the following tasks:

- 24 7. Conduct of Concept meetings and follow-up communication;
- 25 8. Review of proposed MAP Lender and Underwriters and reporting to Asset
26 Management and Counterparty Oversight Division is any concerns;
- 27 9. Working with the Workload Distribution Lead for the Regional Center and other
28 appropriate officials in managing workload assignments for new applications;
- 29 10. Screening applications for completeness, and fiscal controls for new application
30 submissions;

- 1 11. Conducting an “Early Warning System” screening to determine what level of
2 underwriter and technical specialist review is required given the complexity and risk
3 factors associated the transaction, and specific risk issues in the transaction;
- 4 6. After screening or during the underwriting and technical review, the Regional Center
5 or Satellite Office will advise the lender of deficiencies in the application and the
6 lender will have 5 business days to correct the defects or deficiencies. If the
7 defects/deficiencies cannot be corrected within the 5 business days, or such other time
8 frame as the Regional Center Director determines as appropriate, HUD will reject the
9 application.
- 10 11. Acknowledging receipt of the application, management of the queue and estimating
11 processing target dates;
- 12 12. Advising the lender if there are deficiencies or additional information is needed;
- 13 13. Performing technical reviews based on lender underwriting and third party reports, or
14 arranging for technical specialist reviews for higher risk or complex transactions or
15 functions that need specific technical analysis given the features of a particular
16 transaction;
- 17 14. Recommending transactions for loan approval (or rejection) decisions;
- 18 15. Preparing and issuing Pre-application Invitation letters and Firm Commitments;
- 19 16. Coordinating the closing process with OGC, the lender, and borrower’s team;
- 20 17. Coordinating with Asset Management in turnover of files, briefing about conditions
21 of the Firm Commitment, and providing information necessary for Asset
22 Management’s risk rating of the transaction.

23
24 B. Pre-application and Firm Commitment Processing.

25 The HUD underwriter will conduct, or arrange for the Pre-application or Firm
26 Commitment review, including any required technical specialist reviews. The HUD
27 underwriter will coordinate the technical reviews, resolve any inconsistencies and make a
28 recommendation as to whether an application should be approved, modified or rejected
29 and must document and justify any recommendation to approve a loan or to require
30 conditions with which one or more technical reviewers non-concurs.

1 If a HUD technical review does not concur with the conclusions approved by the
2 Regional Center or Satellite Office Director, they may document their non-concurrence
3 separately in the file. The HUD underwriter should address the non-concurrence and
4 document how the issues were addressed in the loan approval decision.

5 Upon completion of the technical reviews and the environmental assessment, the HUD
6 Underwriter will prepare a memorandum to the Regional Center or Satellite Office
7 Director summarizing the individual reviews of the specialists, any proposed waivers of
8 Guide requirements and the Team Leader's overall recommendation.

9 D. Underwriting Recommendation

10 The memorandum recommending loan approval will be in the standard loan committee
11 report or alternative format, and specifically address:

- 12 1. The adequacy of the initial operating deficit for any new construction or substantial
13 rehabilitation loans;
- 14 2. The adequacy of the working capital escrow and construction contingency for any
15 new construction or substantial rehabilitation loans;
- 16 3. The adequacy of the initial deposit and ongoing reserve for replacement;
- 17 4. A description of any non-critical repairs to be performed after closing for Section
18 223(f) loans;
- 19 5. In a tax credit transaction, the schedule of the equity contribution at closing and
20 remainder during construction;
- 21 6. The architectural drawings and specifications; and
- 22 7. Any environmental conditions or other concerns.

23 Back-up documentation necessary to prepare and issue the Firm Commitment should be
24 attached or available, including Previous Participation Certification from APPS, the
25 technical staff reviews, the lender narrative summary, the lender's technical reviews,
26 Forms HUD-92264 and HUD-92264-A signed by the HUD reviewers and Team Leader.
27 Where the HUD underwriter has rejected a conclusion by a technical reviewer, or has
28 modified any technical recommendation by the lender or HUD reviewer, documentation
29 and justification must be included in the memorandum.

30 HUD's review appraisers have the option to modify appraisal conclusions internally or to
31 return the application to the lender for revision of the appraisal. Should the HUD review

1 appraiser choose to modify the appraised value, rent or expense conclusions internally, as
2 per USPAP Standard 3, this opinion becomes its own appraisal whether it concurs with
3 the opinion of value in the work under review or differs from the opinion of value.
4

5 E. Firm Commitment Issuance, Amendments, Reissuance, and Extensions.
6

7 1. Upon issuance of a Firm Commitment, the HUD Underwriter will provide such
8 support as needed and requested to the closing coordinator to prepare for closing,
9 and provide files, data, and information as needed by the Account Executive to
10 facilitate Asset Management's rating and servicing of the loan.

11 2. Firm Commitments will be issued for a term of 60 calendar days. The lender has the
12 option of requesting an extension of the Commitment to prepare for the Initial
13 Endorsement submission. The Regional Center Director may grant one or more
14 extensions for up to a total of 120 calendar days. Further extensions must be
15 approved by the Director of Multifamily Production in HUD Headquarters.

16 When the Regional Center Director determines that extenuating circumstances
17 justify a limited extension of an outstanding Firm Commitment, the lender must
18 certify and Regional Center Director must concur that the documentation provided
19 by the lender demonstrates that granting the extension will not likely change the
20 underwriting data and assumptions on which the Firm Commitment was issued or
21 undermine the feasibility of the project. Such factors include but are not limited to a
22 change in the borrower's or development team's configuration or financial capacity,
23 market, inflation or other factors impacting cost. A change in the interest rate or
24 other terms or conditions of the Firm Commitment may require reprocessing and
25 amendment of the Firm Commitment.

26 If a Firm Commitment has been extended beyond 120 calendar days from its original
27 date, the lender must provide updated appraisal/market study, cost and mortgage
28 credit, or other information as required by the Regional Center or PC for review
29 prior to loan closing.

30 3. Only the Regional Director, Regional Operations Officer, or Production Division
31 Director are authorized to sign Firm Commitments or endorse Insured Mortgage
32 Notes.

- 1 4. The Department has limited flexibility to permit the resubmission of rejected
2 applications. In accordance with the procedures contained in HUD Handbook
3 4410.1 Rev-2, Project Fiscal Procedures will apply.

- 4 4. Amended Commitments. An amended commitment bears the same date as the
5 original commitment, followed by the date of the amendment, although the
6 applicable regulations are those in effect on the original commitment issuance date.
7 Most underwriting changes, such as changes in mortgage amount and/or interest
8 rate, will be incorporated in letter amendments to the commitment.

- 9 F. Reissued Commitments. A reissued commitment will have its own date and will
10 substitute for the originally issued commitment. A lender which accepts a reissued
11 commitment will no longer have rights granted under the original, or a previously
12 amended, commitment. A re-issued commitment is required for:
 - 13 1. Requests for reconsideration of an expired or terminated commitment;
 - 14 2. Changes in project location;
 - 15 3. Major changes in plans and specifications; and
 - 16 4. Reprocessing to reflect changes in the MIP.

- 17 G. Waivers.
 - 18 1. The Regional Center Director may waive requirements of this Guide that are not
19 statutory or regulatory except for the following:
 - 20 a. Debt coverage ratios for all programs;
 - 21 b. Loan to value ratios for Section 223(f) loans;
 - 22 c. Loan to cost ratios for the 221(d) and 220 programs;
 - 23 d. Traditional Application Processing for MAP eligible transactions;
 - 24 e. Substantive modifications to the Ground Lease addendum form (HUD-
25 92070M);
 - 26 f. The requirement for a Single Asset Borrower Entity (see 24 CFR 200.5);
 - 27 g. The prohibition on a lender advancing fees for payment of discounts on behalf
28 of the Borrower;
 - 29 h. Payment of broker or referral fees to any party with an identity of interest with
30 the borrower or its affiliates; and

- 1 i. Extensions of Firm Commitments beyond 180 days of issuance (original term
2 of 60 days plus up to a 120 day extension).
- 3 1. The Regional Center Director will submit to the Director of the Office of Multifamily
4 Housing Production all waiver requests requiring HQ approval as early as possible.
5 Requests for regulatory waivers will take longer to process since they require review
6 and concurrence from the Office of General Counsel and the Deputy Assistant
7 Secretary for Multifamily Housing, as well as the approval of the FHA
8 Commissioner. HQ will not consider waiver requests submitted directly by MAP
9 Lenders.
- 10 2. Any waiver granted in connection with the proposed transaction must be documented
11 in the field office docket and HQ docket, along with the lender's request and field
12 office request. Waivers granted by the Regional Center must be submitted, along with
13 supporting documentation, to the Office of Multifamily Housing Production to
14 determine if changes to this Guide or the regulations are necessary.

11.4 Program Closing Provisions

17 The FHA Multifamily Program Closing Guide addresses various program closing
18 provisions and procedures that the lender must be aware of to prepare for initial closing,
19 final closing and initial/final closing events. The HUD underwriter's responsibilities
20 include:

- 21 A. Ensuring Special Conditions to the Commitment have been satisfied;
- 22 B. Reprocessing and amending Firm Commitments as necessary and appropriate;
- 23 C. Extending or Re-issuing Firm Commitments; and
- 24 D. Coordinating with Asset Management staff to ensure the orderly transition from
25 Production to Servicing.
- 26 E. Coordinating the closing schedule with OGC, the lender, and borrower;

11.5 Loan Fees

- 27
- 28
- 29 A. Loan Fees. Lenders may charge loan origination and placement fees, both of which are
30 mortgageable, and the combination of which cannot exceed 3.5% of the mortgage amount
31 (or 5.5% for tax-exempt bond financing) for Section 223(f) refinancing transactions and

1 new construction or substantial rehabilitation transactions. The maximum fees for Section
2 223(a)(7) loans is 2% for loans greater than \$2 million, and up to \$40,000 for loan
3 amounts less than \$2 million. In addition to loan origination and placement fees, lenders
4 may realize trade profit (also known as marketing gain) on the sale of GNMA or other
5 mortgage backed securities.

6
7 Mortgagee Letter 2011-5 revised the loan fee reporting requirements for multifamily
8 lenders. Lenders are now required to report loan fees earned that exceed five percent
9 (5%) of the insured loan amount on each FHA-insured loan over \$2,000,000 endorsed
10 during the lender's fiscal year period covered in its audited financial statements. Loan
11 fees include: (a) origination and placement fees as permitted by this Guide, plus (b) trade
12 profit, trade premium or marketing gain earned on the sale of the GNMA security at a
13 value above par, even if the security sale is delayed until after endorsement, minus (c)
14 loan fees applied by the lender to its legal expenses incurred in connection with loan
15 closing. This reporting is confidential and is not subject to release under the Freedom of
16 Information Act, but will be examined by HUD in evaluating counterparty risk as part of
17 the lender monitoring responsibility.

18
19 The loan fees on a particular transaction that exceed 5% must be reported by both the
20 originating lender and closing lender when the loan is assigned for closing and fees are
21 split between the two entities. Trade profit fees used to pay prepayment penalties on
22 behalf of a borrower in a Section 223(a)(7) transaction are not net out of the loan fees in
23 calculating whether or not the loan fees exceeded 5%.

24 B. Loan fees are earned are as follows:

- 25 1. Construction loan fees are earned at initial closing, except to the extent that the loan
26 documents defer a portion to a later date. Construction loan extension fees are not
27 earned until the time such extensions are granted.
- 28 2. Permanent loan fees and permanent loan extension fees, to the extent a separate
29 permanent loan is anticipated, are earned at final closing.
- 30 3. Construction/Permanent loan fees (for construction loans anticipated convert to
31 permanent loans) are earned at initial closing, except to the extent that the loan
32 documents defer a portion to a later date.

33
34 C. Deferred Fee Collection. Section 8.15.D.4 sets forth provisions for the deferred
35 collection of fees in connection with tax-exempt bond financing.

1 D. Broker's Fees.

- 2 1. Fees to mortgage brokers are allowed so long as they are disclosed in the
3 Underwriting Narrative and form HUD-92434M (or HUD-92455M, as appropriate),
4 there is no identity of interest between the mortgage broker or its affiliates, and the
5 borrower or its affiliates, and the broker is actively engaged in the business of
6 mortgage loan origination.

7 Referral fees to other parties, such as consultants, management agents, or entities or
8 individuals with any identity of interest with the borrower or its affiliates are
9 prohibited.

- 10 2. Lender or affiliates of lenders may not pay anything of value directly or indirectly to
11 any person or entity in connection with an insured transaction if the person or entity
12 has received any other compensation from borrower, seller, builder or any other
13 person for services related to the transaction, or related to the purchase or sale of the
14 mortgaged property, except as approved by the Director of Multifamily Production in
15 HUD Headquarters. See 24 CFR 202.5(1).
16

17 **11.6 Title Matters**

- 18 A. As noted in the Application Checklist, a preliminary or pro forma title search should be
19 reviewed as part of the firm commitment processing. It is used to validate existing
20 indebtedness, ensure correct legal description of the parcel(s) to be mortgaged, and the
21 adequacy of title with respect to matters such as liens, easements, and exceptions. Please
22 see the FHA Multifamily Program Closing Guide for additional requirements related to
23 title matters.

24 B. Air Rights and Other Shared Interest Projects

- 25 1. A three dimensional air rights map for air rights projects is required. The existence of
26 adequate vertical ways to the ground for required services, e.g., utility and fire
27 suppression lines, chimneys, trash chutes, elevators and emergency exit stairs must be
28 verified. In addition, there must be an acceptable discharge to a public way from all
29 building egresses, including emergency exits, and services, e.g., trash removal.
- 30 2. Maintenance, joint use, easement and other agreements may be required. In cases
31 where common facilities exist between the insured parcel and an adjacent parcel,
32 borrower must provide for recordation of an agreement for the common use land and
33 facilities, e.g., common drives, common lobbies, elevators, walkways, utility roads,

1 parking structures, recreation facilities, storm water management facilities (retention
2 ponds detention ponds, swales and culverts) or other air rights project common
3 facilities. The agreement must grant rights to the HUD project site and its residents to
4 use the common facilities. If the HUD project is subject to property/homeowner
5 association documents such as with a cooperative, these documents may provide for
6 maintenance, access and cost sharing.

- 7 3. The Regional Center Director must:
- 8 a. Assure that the integrity and maintenance of air rights platform foundations and
9 other structural members are defined as the air rights provider's responsibility.
 - 10 b. Verify that shared maintenance/operating costs are equitable and that enforcement
11 rights protect the project interests.
 - 12 c. Require easements, cross easements or other documents to provide the HUD
13 project and its residents the right to use the common facilities.

14 **11.6 Borrower Entity's Organizational Documents**

15 A. Borrower Entity's Organizational Documents

- 16 1. General. Draft (or final) organizational documents should be reviewed as part of the
17 creditworthiness analysis during firm commitment underwriting. Organizational
18 documents for the borrower entity are required to be submitted at closing. The
19 specific documents required for each type of borrower entity are set forth in the FHA
20 Multifamily Program Closing Guide. These requirements apply to all types of
21 closings including initial, initial/final, and final endorsements. For multi-tier entities,
22 mortgagor entities will also be required to submit organizational documents for the
23 tier at which Multifamily Regional Center staff has determined ultimate control over
24 the day-to-day operations of the project resides.
- 25 2. Terms. The documents must expressly state:
 - 26 a. That the duration of the borrower entity is at least as long as the term of the FHA-
27 insured mortgage.
 - 28 b. That the terms of the HUD Regulatory Agreement take precedence in the event of
29 any conflict with the terms of the organizational documents.
 - 30 c. That the borrower entity has authority to enter into the transaction and to comply
31 with the requirements of the insurance program.
 - 32 d. That unless approved otherwise by HUD, the borrower entity is a single purpose-single
33 asset entity.

11.7 Note

- A. Term. The term must be the same as specified in the firm commitment, which must be within the maximum terms allowed by the program and not less than 10 years.
1. Generally, for most new construction or substantial rehabilitation rental projects, the term, calculated from the date of completion of construction, may not exceed the lesser of 40 years or 75% of the project's remaining economic life.
 2. For existing projects (insured under Section 207 pursuant to Section 223(f)), the term must be not less than 10 years, and may not exceed the lesser of:
 - a. 35 years, or
 - b. 75% of the estimated remaining economic life of the physical improvements.
 3. For 223(a) (7) projects, the term of the mortgage is limited to 12 years beyond the remaining term of the existing mortgage (excluding any previous Section 223(a)(7) loan) so long as the PCNA and underwriting determine that the loan term is no more than 75% of the remaining useful life of the property.
- B. Prepayment Provisions. Generally, prepayment lockout and/or penalty structures that expire after 10 years and are no more than 10% during any of the first 10 years, and no more than 1% thereafter are acceptable, so long as the interest rate is commercially reasonable at the time of the rate lock.

The following additional conditions and terms apply:

1. Market rate properties.
 - a. Prepayment must be permitted in whole or in part so long as 30 days advance written notice is given to lender of intent to prepay, except for Section 223(f) loans, which must meet certain conditions and receive HUD approval if the property will be converted to a use other than rental housing.
 - b. Prepayments must be permitted for up to 15% of the original principal amount in any one calendar year without a prepayment charge. Prepayments exceeding 15% may be subject to a reasonable charge agreed to by borrower and lender and included in the Mortgage.
 - c. Notwithstanding the borrower's right to prepay, a HUD 9807 must be processed in order for HUD to release the recorded Regulatory Agreement.
2. Affordable or subsidized properties.
 - a. FHA insured projects which are, or formerly were, affordable or subsidized and are subject to a Use Agreement, Regulatory Agreement, or similar restrictive covenants, require prior written consent of HUD to prepay the mortgage debt.

- 1 b. HUD may approve partial prepayments to reduce succeeding monthly payments
2 over the remaining portion of the original mortgage term, or may also approve
3 partial prepayments made after 30 days written notice. Prepayments exceeding
4 15% of the original principal amount may be subject to a reasonable charge on
5 such excess as agreed to by borrower and lender and included in the Mortgage.
- 6 3. State and Local Bond-Financed Projects. Subject to compliance with Section 11.7.C,
7 projects funded from tax-exempt or taxable bonds issued by State or local
8 governmental bodies may include the following prepayment restrictions and
9 prepayment penalty charges in Rider 1 of the Note:
- 10 a. Prepayment restriction period (lockout) must not exceed 10 years plus the
11 construction period stated in the construction contract, or, in the alternative, must
12 not exceed 10 years from the commencement of amortization.
- 13 b. Prepayment penalty may be charged after expiration of the lockout stated
14 immediately above, provided the charge:
- 15 (1) During the first year following the lockout does not exceed 5% of the
16 original mortgage,
- 17 (2) Declines on a graduated basis (to the extent practicable, the decline in
18 the penalty percentage should be the same each year), and
- 19 (3) Does not exceed 1% at the end of the fifth year following the lockout.
- 20
- 21 4. Other Bond Obligations or GNMA Mortgage-Backed Securities. “Other bond
22 obligations” refers to any agreement under which lender has obtained the mortgage
23 funds from third party investors and has agreed in writing to repay such investors at a
24 stated interest rate and in accordance with a fixed repayment schedule. Mortgages
25 funded with the proceeds of GNMA Mortgage-Backed Securities or other bond
26 obligations acceptable to HUD may include the following prepayment restrictions and
27 prepayment penalty charges in Rider 1 of the Note.
- 28
- 29 a. A lockout not to exceed 10 years plus the construction period stated in the
30 construction contract, or in the alternative, not to exceed 10 years from the
31 commencement of amortization; or
- 32 b. A prepayment penalty charge provided the charge:
- 33 (1) Does not exceed 10% at the end of the first year following the construction
34 period stated in the construction contract or the commencement of

1 amortization,

2 (2) Declines on a graduated basis, and

3 (3) Does not exceed 1% at the end of the 10th year following the construction
4 period stated in the construction contract.

5
6 If the initial penalty is 3% or less the HUD override language in paragraph 3 below, is
7 not required; the penalty can be as great as 10% if the override language is included;
8 or

9 c. A combination lockout and penalty charge in which the foregoing lockout and
10 penalty provisions apply, but in addition:

11 (1) The lockout period does not exceed 10 years plus the construction period
12 stated in the construction contract, or in the alternative, 10 years from the
13 commencement of amortization, and

14 (2) The prepayment penalty does not exceed 1% at the end of the tenth year
15 following the construction period stated in the construction contract or
16 commencement of amortization.

17 C. Conditions for Including Lockouts and/or Penalties. Compliance with the following
18 conditions is required when prepayment lockouts and/or penalties are permitted.

19
20 1. Lender's Certificate and Request for Endorsement. The Lender's Certificate, Form
21 HUD-92434M (section 24(a)) and the Request for Endorsement, Form HUD-92455M
22 (section 25(a)), requires the lender to certify that in the event of a default during the
23 term of the prepayment lockout and/or penalty (i.e., prior to the date on which
24 prepayment may be made with a penalty of one percent or less), it will comply with
25 Program Obligations. The Lender, in order to comply, must:

26 a. Request a 3-month extension of the deadline prescribed by 24 C.F.R.
27 Section 207.258 for filing a notice of its intention to file an insurance
28 claim and its election to assign the mortgage;

29 b. Assist the Borrower to arrange refinancing to cure the default and
30 avert an insurance claim if HUD grants the requested (or shorter)
31 extension of the notice filing deadline;

32 c. Report to HUD at least monthly on any progress in arranging a
33 refinancing;

- 1 d. Otherwise cooperate with HUD in taking reasonable steps to avoid an
2 insurance claim;
- 3 e. Require any successors or assigns to certify in writing that they agree
4 to be bound by these conditions for the remainder of the term of the
5 prepayment lockout and/or penalty period; and
- 6 f. Notify HUD of the delinquency where a payment is not received by the 16th day
7 of the month in which it is due.
- 8 D. Late Charge Provisions. Lender may collect a late charge for the cost of handling
9 delinquent payments, subject to the following:
- 10 1. Charges must not exceed two cents per dollar of unpaid principal and interest that is
11 more than 10 days in arrears.
- 12 2. Late charges must be separately charged to and collected from borrower and cannot
13 be deducted from any total monthly mortgage payment, or collected from any reserve
14 escrow, residual receipts funds, or from any interest accruals thereto.
- 15 E. Where obligations pursuant to tax-exempt bond financing or GNMA involvement do
16 not impose restrictions independent of the lender's restrictions, HUD may consider
17 exercising an override of prepayment lockout and/or premium provisions imposed by
18 the lender if:
- 19 1. Borrower has defaulted on the insured loan and HUD has received notice as
20 required by the regulations;
- 21 2. HUD determines that the project has been experiencing a net income
22 deficiency, which has not been caused solely by management inadequacy or
23 lack of owner interest, and which is of such a magnitude that the borrower is
24 currently unable to make required debt service payments on the insured loan,
25 pay all project operating expenses and fund all required HUD reserves;
- 26 3. HUD finds there is a reasonable likelihood that the Borrower can arrange to
27 refinance the defaulted loan at a lower interest rate or otherwise reduce the
28 debt service payments through partial prepayment; and
- 29 4. HUD determines that refinancing the defaulted loan at a lower rate or partial
30 prepayment is necessary to restore the project to a financially viable condition
31 and to avoid a full insurance claim.

- 1
2 F. If an event of default occurs during a period in which prepayment may not be made or
3 may not be made without a penalty of one percent or less, lender must:
- 4 1. request a 3-month extension of the deadline prescribed by 24 C.F.R.
5 Section 207.258 for filing a notice of its intention to file an insurance
6 claim and its election to assign the mortgage;
 - 7 2. assist the Borrower to arrange refinancing to cure the default and avert an
8 insurance claim if HUD grants the requested (or shorter) extension of the
9 notice filing deadline;
 - 10 3. report to HUD at least monthly on any progress in arranging a refinancing;
 - 11 4. otherwise cooperate with HUD in taking reasonable steps to avoid an
12 insurance claim;
 - 13 5. require any successors or assigns to certify in writing that they agree to be
14 bound by these conditions for the remainder of the term of the prepayment
15 lockout and/or penalty period; and
 - 16 6. notify HUD of the delinquency where a payment is not received by the
17 16th day of the month in which it is due.

Chapter 12 Construction Period

12.1 Start of Construction

- A. Start of initial construction is the date when contract work commences. It must be diligently pursued without appreciable delay between activities, includes site clearance and other preparatory site work.
- B. Early start of construction may be authorized in accordance with early start procedures (see Section 5.7). Where it occurs:
 1. A pre-construction conference is required before the start of initial construction;
 2. Construction inspections and change orders must be done in accordance with this chapter;
 3. Authorization of any insured advances cannot occur until the endorsed instrument is recorded at initial closing.

12.2 Pre-Construction Conference

A pre-construction conference is required for every project and must precede the initial start of construction, including early start of construction. The HUD Inspector usually conducts the pre-construction conference and should hold it at initial endorsement where feasible, with the major participants present. The pre-construction conference may be conducted by the HUD Construction Coordinator (or designate), if the HUD Inspector is unable to attend, and may be scheduled shortly before or after the initial endorsement if necessary.

- A. Required attendees:
 1. Borrower's representative;
 2. Borrower's supervisory Architect;
 3. General contractor;
 4. Major subcontractor(s);
 5. HUD representative;
 6. HUD mortgage credit analyst; and

- 1 7. Lender’s representative.
- 2 B. Supplementary Conditions of the Contract for construction, Form HUD-92554M. The form
3 must address Davis-Bacon wage rates, Federal labor standards and equal employment
4 provisions, including:
 - 5 1. Contract obligations of the general contractor and all subcontractors, including:
 - 6 a. Certification of compliance with Davis-Bacon wage rates with each request for
7 advances.
 - 8 b. Davis-Bacon wage rates also apply to a second mortgage securing a governmental
9 loan.
 - 10 2. Statement of sanctions that may be imposed for not complying with the supplemental
11 conditions.
 - 12 3. Requirement that the applicable Davis-Bacon wage decision and the Form HUD-
13 92554M must be made part of the subcontracts for all tiers.
 - 14 4. Emphasize the importance of Federal wage payments, prompt certified payroll
15 submissions and proper record keeping. Instruct that a copy of the applicable Davis
16 Bacon wage decision and Form WH-1321, Notice to Employees, must be
17 conspicuously posted on the job site.
 - 18 5. Indicate who on the HUD labor relations staff will review for labor standards
19 compliance and refer any further inquiries concerning Davis-Bacon wage and
20 reporting requirements to that staff.
 - 21 6. Give copies of the Equal Opportunity poster to the general contractor and the
22 subcontractor(s) to post conspicuously at the job site.
 - 23 7. Make available copies of HUD’s Contractor’s Guide to Davis-Bacon.
- 24 C. Contract Administration
 - 25 1. Explain general contract administration, including responsibilities of the lender,
26 borrower, borrower’s Architect, general contractor, and HUD representative.
 - 27 2. Explain the procedures for:
 - 28 a. Change orders;
 - 29 b. Requesting construction document clarifications;
 - 30 c. Reporting and correcting non-compliant work;
 - 31 d. Requesting periodic payments and release of escrows;
 - 32 e. Substantial completion of work or portion thereof; and;
 - 33 f. Permissions to occupy, including management plans and rent rolls.

- 1 3. Stress that work changes completed in anticipation of a future change order will be
2 regarded as non-compliant. There will be no insured advances for it or other work
3 dependent on it.
- 4 4. Periodic advances. Explain:
 - 5 a. Borrower's and general contractor's required preparation of requests, including
6 the field approval and subsequent processing;
 - 7 b. Provisions for submitting surveys, title reports, and other documentation in
8 support of construction advances;
 - 9 c. Requirements for contractor's retainage and its release.
- 10 5. Stored materials. Explain procedures to request payment for materials stored onsite,
11 and components stored offsite where applicable. (See Appendices 12B and 12C)
- 12 6. Offsite work. Explain procedures to request payment for completed offsite work, the
13 required retainage and its release.
- 14 7. Termination of contract(s). Discuss provisions for terminating the construction
15 contract and/or Architect's contract, and the lender's responsibilities during the
16 construction stage and in the event of a default.

17 D. Cost Certification

- 18 1. Summarize cost certification requirements for the mortgagor and (if applicable) the
19 general contractor, subcontractors, equipment lessors and suppliers, and industrialized
20 housing manufacturers. Where there is a second mortgage securing a Governmental
21 loan, advise that cost certification also applies to the second mortgage.
- 22 2. Inform all parties that a pre-cost certification conference will be held when
23 construction is 90% complete and that detailed instructions will be provided at that
24 point.
- 25 3. Stress that:
 - 26 a. Identities of interest that develop or become known after initial closing must be
27 reported to the lender and to HUD within 5 working days of having such
28 knowledge;
 - 29 b. HUD must give prior approval for all identity of interest subcontractors and apply
30 penalties where this is not done;
 - 31 c. Self-owned equipment must be certified; and
 - 32 d. Paper conduits are prohibited.
- 33 4. Clarify the 50/75 percent rule (see Section 13.15).

12.3 HUD Construction Monitoring

A. Purpose of Inspection.

1. Inspection means the periodic observations made of rehabilitation/ construction at the site of a multifamily housing project by a HUD representative (inspector) for the purpose of protecting HUD's interests. Inspections are made to evaluate the contractor's and Architect's performance, to obtain construction in accordance with the contract documents, and to report on conformance with prevailing wages and other contract requirements.
2. The instructions for inspection are the same for projects involving the insurance of advances and those to be insured upon completion, except for those variations specifically stated to be applicable to one or the other.

B. Access. At all times, HUD has the right of access to the property and the right to inspect all work performed and materials furnished to complete the project.

C. HUD Construction Manager's/Coordinator's duties. The HUD construction manager (CM) or architectural designee is responsible for the proper performance of all functions relating to inspection, as well as the instruction and supervision of all HUD personnel involved. The CM must be kept informed of the general progress of the work on all projects during the construction stage and guarantee period and must be familiar with the problems involved.

1. Assignment. The CM will assign either a HUD construction analyst or a contractor to inspect a project before the start of construction. The person inspecting the project may be a Design Representative, a Construction Representative, or a person or group hired by HUD to do the inspections, referred to as an "inspector." The CM will select the inspector on the basis of competency with regard to the scope of the project and to the type of construction involved. Several projects being constructed concurrently may be handled by one inspector. Only in very unusual circumstances will an inspector be assigned full time to any one project. Upon assignment, the CM will issue to the inspector the following:
 - a. Set No. 3 of the contract drawings and specifications. This set becomes the HUD as built set for the inspector to conform it to the contractor's "Record Set."
 - b. Copy of the construction contract. The required Contract for insured advances is the HUD Construction Contract, HUD-92442M, which contains alternate provisions for cost plus and lump sum contracts. The form may or may not be used in insurance upon completion cases, but a construction contract in some form is required and must be furnished to the inspector.

- 1 (1) Form HUD-92442M, Construction Contract-Lump Sum, may be used
2 when there is no identity of interest between the borrower and the
3 contractor.
- 4 (2) Form HUD-92442M, Construction Contract-Cost Plus, may be used in
5 any case, and shall be used when there is an identity of interest between
6 the borrower and contractor.
- 7 c. Owner-Architect Agreement, AIA Document B-108, when an Architect is
8 required to administer the construction contract.
- 9 d. Contractor's and/or borrower's cost breakdown - Schedule of Values, Form HUD-
10 2328 when insured advances are involved.
- 11 e. Drawings and specifications pertaining to off-site improvements.
- 12 f. Agreements or contracts providing for off-site construction.
- 13 2. Field Supervision. The CM shall keep informed of the general quality of
14 inspections and the performance of inspectors by maintaining close contact with
15 their work through job site visits. A regular routine for supervising field
16 operations should be established and followed. Required methods of field
17 supervision follow:
 - 18 a. A minimum of one (or more where appropriate) field review inspections shall
19 be made on each project to evaluate the performance of the HUD inspector.
20 Field review inspections shall be recorded on a HUD Representative's Trip
21 Report, Form HUD-95379.
 - 22 b. Construction should be field reviewed where the use of questionable methods
23 of construction, materials, uncorrected non-compliance, or other problems are
24 reported.
 - 25 c. Projects should be field reviewed at construction stages where problems have
26 occurred in that jurisdiction.
- 27 3. Office Review. The CM shall review all Trip Reports, Forms HUD-95379,
28 completed by the HUD inspectors. If the reported conditions indicate the
29 necessity for desirability of field review or other special handling, appropriate
30 action shall be initiated.
 - 31 a. Review should not be restricted to the entries on the report. The absence of
32 significant evaluation comments may, under certain circumstances, indicate
33 desirability of field review.
 - 34 b. The CM should be aware of progress, trends, new or uncorrected non-compliance,
35 unusual conditions, etc., in order to be familiar with the work and to initiate any
36 required corrective action immediately.

- 1 c. The inspector shall be advised of any unsatisfactory action or detail in the
2 report, or any error in its preparation, so that similar mistakes will not occur in
3 the future.
- 4 4. Training.
- 5 a. Inspection conferences shall be held when deemed necessary by the CM. The
6 purpose of the conference is to maintain and improve the quality and efficiency of
7 the construction observation function.
- 8 b. Field and office review of inspections will indicate individual training needs and
9 subjects for discussion at inspection conferences.
- 10 c. It is essential that new inspectors and new staff be trained in the field as well as in
11 the office.
- 12 5. Construction progress meetings. During construction, the contractor, mortgagor,
13 mortgagor's supervisory Architect and the HUD inspector must attend monthly job
14 meetings at the job site when a monthly request for advances are prepared.
- 15 a. The owner's representative must be a member of the borrower entity, usually a
16 general partner. Nonprofit organizations may be represented by a member of the
17 Board of Directors.
- 18 b. The HUD Inspector must:
- 19 (1) Comment to the group on the quality of construction and of the Architect's
20 observations and the contractor's supervision.
- 21 (2) Comment on all known construction defects and deficiencies (non-
22 compliance) and methods of correction.
- 23 (3) Explain that changes in the work from the contract documents (non-
24 compliance) must be resolved by approved change order requests or the
25 work done in accordance with the contract documents.
- 26 (4) Inform parties of HUD policy for holdback of construction advances until
27 non-compliance is corrected.
- 28 (5) Record on Form HUD-95379 the issues raised at the meeting. Significant
29 concerns of any party should be presented by memorandum through the
30 CM to the Regional Center Director.
- 31 c. Monthly meetings may also be used to resolve equal opportunity and labor
32 disputes. When such disputes are known, the HUD Labor Relations and Equal
33 Employment officers must be invited to attend.

1 D. Inspector's Duties. The inspector is a HUD representative, not a superintendent for the
2 contractor or "clerk of the works" for the owner or Architect. The inspector, as HUD's
3 agent, must endeavor in a tactful, helpful and courteous manner to obtain construction
4 that conforms to the drawings, specifications, and sound construction practice within the
5 scope of the contract. The inspector must be factual and specific in all statements in
6 reporting and recording significant construction developments observed.

7 1. Orientation. Upon assignment to a project, the inspector will study the drawings
8 and specifications and become familiar with the conditions at the site. If, during
9 this examination or during construction, any nonconformity with HUD
10 requirements or site conditions not considered in the design is found, they are to
11 be reported by memorandum through the CM to the Regional Center Director. The
12 Regional Center Director will work with the lender, owner, contractor and other
13 related parties to resolve the noncompliance.

14 2. Facilities. The contractor must furnish the inspector with enclosed working space that
15 is acceptable to HUD. Adequate, but not elaborate, facilities should be required as
16 soon as actual construction begins at the site.

17 3. Inspections. The inspector shall make at least one job site visit each month, except
18 when HUD determines no inspection is necessary due to the progress of the work in a
19 particular period. Additional visits may be necessary due to the nature of the project.
20 The frequency of inspection should assure reasonable continuity and recognize the
21 size and character of the project, the speed with which construction is progressing and
22 the quality of work on the project. Visits should be scheduled to observe major
23 construction operations without neglecting lesser operations. Sufficient time must be
24 allotted to each visit to make a complete inspection.

25 a. The major functions during inspection are to: Evaluate the construction
26 supervision of the contractor and contract administration of the Architect; report
27 on occupancy, delays, disputes, and changes; report noncompliance with the
28 contract documents observed by the inspector and/or the supervisory Architect;
29 determine that the amounts requested by the contractor and recommended by the
30 Architect for payment are reasonable; conduct employee wage interviews using
31 Form HUD-11; and report on labor and EEO compliance.

32 b. Each inspection shall be recorded on a HUD Representative's Trip Report, Form
33 HUD-95379.

34 c. Reporting requirements. The following documents executed during inspection
35 must be promptly sent to the CM, the project Architect and the lender's
36 Construction Loan Administrator:

37 (1) HUD Representative's Trip Report, Form HUD-95379:

- 1 Original to the CM, with copies to the Architect and the lender's
2 Construction Loan Administrator.
- 3 (2) Contractor's Requisition, Form HUD-92448:
4 Original to the lender's Construction Loan Administrator for signature with
5 copies of the signed document to the CM, the Architect and the HUD
6 inspector.
- 7 (3) Change Order Form HUD-92437:
8 Original to the lender's Construction Loan Administrator for signature with
9 copies of the signed document to the HUD CM, the Architect, and the HUD
10 inspector.
- 11 (4) Permission(s) to Occupy, Form HUD-92485:
12 When all required signatures (mortgagor, architect, and contractor,
13 mortgagee, and HUD inspector) are affixed, the document will be sent to the
14 HUD CM for approval. Upon signing by the FHA authorized agent, copies
15 are sent to the lender's Loan Administrator, the Architect, and the HUD
16 inspector.
- 17 4. Start of Construction. The inspector will report the date of initial construction start
18 and the date of the start of permanent construction on Form HUD-95379.
- 19 a. The date of the initial construction start, used for recording and reporting
20 purposes, is the "start of construction" as used in connection with labor standards
21 and prevailing wage requirements. This is defined as the beginning of initial site
22 clearance and preparation, provided these activities are pursued diligently and are
23 followed, without appreciable delay, by other construction activities.
- 24 b. The date recorded as the start of permanent construction, used for the purpose of
25 determining the earning of the inspection fee, will correspond to the first day that
26 permanent on-site building elements were put into place, such as footings and/or
27 foundations, pilings, utility lines, etc.
- 28 c. While excavation is an integral part of foundation work, it does not constitute a
29 start of permanent construction.
- 30 5. Unified Report. At the beginning of construction, the inspector should consult
31 with the HUD Design Representative and the CM in regard to the need for
32 inspection of the project by HUD technical specialists. Any differences of opinion
33 between the inspector and the technical specialist in regard to project construction
34 will be resolved by the CM. The inspector must submit a unified inspection report
35 to the Architect and the lender.
- 36 6. Shop Drawings and Other Data. During the construction period, the inspector must
37 check whether shop drawings are being submitted by the contractor for approval by

- 1 the Architect as required by the AIA General Conditions of the Contract. Upon
2 request by the Architect or the inspector, the contractor will keep copies of tests,
3 certifications and any other data required by the contract documents onsite for review.
- 4 7. Off-site Fabricated Construction. If off-site fabricated construction components are
5 involved, the CM will determine if there is a need for inspection at the factory to
6 determine acceptability. If the manufacturing facilities are outside of the jurisdiction
7 of the HUD Office and inspection is essential, the CM will submit pertinent drawings
8 and specifications, together with a request to the Regional Center Director to have the
9 inspection made by the HUD Office located near the factory.
- 10 8. Distribution. If an Architect is not required for contract administration, then where
11 these instructions require the HUD inspector to submit findings to the Architect, they
12 are to be submitted to the contractor.
- 13 9. Work Stoppage. The HUD inspector will report to the CM on Form HUD-95379 any
14 work stoppage unless such stoppage is due to inclement weather or similar reasons. If
15 known to the inspector, the reason for the work stoppage should be stated and when
16 resumption of construction is anticipated.
- 17 10. Occupancy. The HUD inspector will complete the portion, "FHA Inspection Report,"
18 of Form HUD-92485, Permission to Occupy, when submitted, to request permission
19 to rent or occupy specific living units, commercial or other space. The Form is to be
20 submitted when the inspector reports safe ingress and egress to the units and/or
21 building, as evidenced by a certificate of occupancy from the locality. Units and
22 spaces should not be occupied prior to approval by HUD. The Regional Center
23 Director and MAP Coordinator should determine who in the Regional Center or PC
24 will approve the permission to occupy.
- 25 a. Occupancy prior to the execution of Form HUD-92485 will be reported to the
26 Regional Center Director by written memorandum.
- 27 b. The inspector will also include on the Form HUD-95379, the number of units
28 occupied prior to approval, as well as the date occupancy took place.
- 29 11. Additional duties of the `inspector:
- 30 a. Advises the Architect administering the construction contract on HUD
31 requirements;
- 32 b. Reviews the Architect's job log;
- 33 c. Reviews copies of the Architect's decisions;
- 34 d. Reports on project construction progress to the CM on Form HUD-95379;
- 35 e. Notifies the Architect and the contractor if an identity of interest exists between
36 the owner and the contractor, or if it is determined that there are any essential

- 1 variations in the cost of the work installed, materials stored and the request for
2 construction advances recommended by the Architect; and
- 3 f. Conducts interviews with an appropriate sampling of the laborers and mechanics
4 engaged and records interview information on Record of Employee Interview, Form
5 HUD-11, in connection with wage and labor compliance in the construction of the
6 project.
- 7 12. Construction record. From the initial construction start through final inspection, the
8 inspector shall be responsible for maintaining a record of construction that includes
9 minutes of the pre-construction conference as well as reports of required guarantee
10 inspections. The inspector shall keep a record binder when the CM first assigns the
11 project or may elect to expand the project record binder to include inspection reports. All
12 forms, reports, decisions and documents relevant to construction or inspection reporting
13 shall be recorded in the binder in chronological order. The journal shall be on the left
14 side of the binder and forms and documents on the right. The forms and documents listed
15 below shall be included in the Construction Inspection Record Binder, when applicable.
- 16 a. Drawings and specifications: Sets 1, 2, and 3 referenced in journals though filed
17 elsewhere (record the storage location of set 1 and use of 2 and 3).
- 18 b. Off-site drawings and specifications (referenced in journal).
- 19 c. Construction Contract, Forms HUD-92442M.
- 20 d. Owner-Architect Agreement.
- 21 e. Progress schedule.
- 22 f. Contractor's and/or borrower's Cost Breakdown, Form HUD-2328.
- 23 g. HUD Representative's Trip Report, Form HUD-95379.
- 24 h. Contractor's Requisition, Form HUD-92448.
- 25 i. Change Orders Form HUD-92437, AIA G710, and Architect's supplemental
26 instruction or equivalent.
- 27 j. Letters, memoranda, notes, and worksheets.
- 28 k. Journal of Architectural Actions (if separate binder).
- 29 l. Surveyor's Report, Form HUD-92457M (final and others, if requested).
- 30 m. Permission(s) to Occupy, Form HUD-92485.
- 31 n. Record of established escrows including amounts escrowed and a complete list of
32 unfinished construction items, record of call back inspections and
33 recommendations for monies to be released.
- 34 13. Projects of Insurance upon Completion. The inspector will report the percentage of
35 completion of the project on Form HUD-95379 at the end of each month. This

- 1 percentage is an approximation for general information and is not used for
2 disbursement.
- 3 14. Off-site inspection. The inspector checks all off-site construction for conformity with
4 the terms of the contract and reports work progress by percentages on Form HUD-
5 95379. Completion is reported on Form HUD-92464.
- 6 E. Reporting and dealing with serious construction problems. HUD Offices must identify
7 and report, by electronic mail, to the Regional Center Director and AMCOD all insured
8 multifamily projects under construction or in the guarantee period that have serious
9 construction defects or other serious construction related problems. This information
10 will be used to reply to inquiries, as an "early warning system" on troubled projects,
11 and to determine if assistance by the HUD Office is necessary.
- 12 1. The inspector must identify all construction problems that may delay completion or
13 lead to foreclosure or assignment of the mortgage to HUD by using Form HUD-
14 95379, HUD Representative's Trip Report.
- 15 2. The CM must prepare a referral memorandum to the Regional Center Director when:
16 a. Work stops for 20 calendar days;
17 b. There are slow payments or non-payments to the general contractor and/or
18 subcontractors;
19 c. Contractor abandons the job;
20 d. Contractor, owner or Architect changes during construction;
21 e. Correction of any construction deficiency is not started within 30 days of the first
22 notification to the contractor; or
23 f. Contractor can't or won't correct any construction defect or latent defect.
- 24 3. The referral memorandum must include full details of the construction related
25 problem, including:
26 a. A copy of Form HUD-95379, which identifies the problem.
27 b. The inspector's opinion of the cause and recommendation for correction.
28 c. A report of action by the CM and/or other HUD Office staff.
29 d. A report of actions by the owner, Architect, contractor, mortgagee and bonding
30 company (when appropriate).
31 e. A plan of action to be undertaken by the HUD Office if the mortgage is assigned
32 to HUD during construction or foreclosure is initiated by the lender.
- 33 4. Only the initial report is required unless the Regional Center Director requests further
34 action or follow-up by the HUD Office.

- 1 5. For complete instructions on handling problems before final closing, see Appendix
2 13D.

3 **12.4 Architect's Duties in Administering Construction** 4 **Contract**

6 The Architect shall:

- 7 A. Provide services in accordance with the Owner-Architect Agreement.
- 8 B. Have no identity of interest with the owner or contractor. An identity of interest is
9 defined in the HUD Amendment to the B108, Owner-Architect Agreement.
- 10 C. Ensure that construction is carried out in accordance with the contract documents,
11 including:
- 12 1. Restrict materials, products and equipment to those specified.
- 13 2. Restrict all deviations to those substantially consistent with the original design
14 concept including form, color, and texture.
- 15 3. When arriving at the net amount due on every requisition, compare the cost of the
16 work and materials with the cost to complete the project. Current and previous
17 payment must relate to the total cost for completion.
- 18 4. Restrict substitution of items of a different design or size from those specified to
19 those that are equivalent in utility (i.e., durability, quality, and ease of maintenance).
- 20 5. Restrict substitution of any material differing in composition or appearance from the
21 one specified to one which is equivalent in its attributes (i.e., character, quality,
22 durability and ease of maintenance).
- 23 6. Keep a log on the site that is readily available to the mortgagor and HUD
24 representatives.
- 25 D. Architect's supplemental instructions. The architect administering the construction
26 contract may issue field orders using AIA Document G710, Architect's Supplemental
27 Instructions, or a similar form.
- 28 1. The architect must send a copy of each supplemental instruction to HUD, although
29 prior approval by the lender and HUD is not required.
- 30 2. Supplemental instructions must not involve a change in contract sum or contract time.
- 31 3. Supplemental instructions may be used to:

- 1 a. Direct the contractor to bring construction into compliance with the contract
- 2 documents.
- 3 b. Interpret or clarify the contract drawings and specifications.
- 4 c. Order minor changes in the work, not involving cost.
- 5 d. Accept specified equivalents.
- 6 e. Record other "field orders" that are not construction changes.
- 7 E. The Architect administering the construction contract is responsible for reporting in
- 8 writing the results of periodic visits to the construction site. The Architect's log should
- 9 provide information regarding assessment of the progress of the work and a record of the
- 10 actions taken to insure that the work is being accomplished in the best interests of all the
- 11 parties.
- 12 1. The American Institute of Architects (AIA) Document G711, Architect's Field
- 13 Report, may be used for the log.
- 14 2. A log of each visit should show, at a minimum, the following:
- 15 a. Date of inspection.
- 16 b. HUD project identification and location.
- 17 c. Time, weather, and temperature range.
- 18 d. Estimated percent of completion.
- 19 e. Work in progress and conformance with the contractor's progress schedule.
- 20 f. Persons present at work site.
- 21 g. Observations and items to verify.
- 22 h. Information or action required.
- 23 i. Firm name and signature.

24 **12.5 Architect's Adequacy**

25
26 The Architect's administration of the construction contract is covered by the Owner-Architect
27 Agreement and by the General Conditions of the Contract for Construction, AIA Document
28 A201. The HUD inspector is responsible for determining the adequacy of the Architect's
29 administration, which determination will not be based just on the number of visits or the length
30 of time spent by the Architect on the job, but on whether the construction complies with the
31 contract documents based on the Architect's observations.

- 1 A. Deficient administration. If the Architect does not report all observed non-compliances
2 with contract documents and unacceptable performances by the contractor and pursue all
3 avenues to obtain compliance with the contract, then the Architect's administration of the
4 construction contract will be considered deficient. The Architect will not be responsible
5 for actual construction, construction means, methods, techniques or other related
6 responsibilities of the contractor. However, on the basis of on-site observation as the
7 owner's representative, the Architect must keep the lender, owner and HUD informed of
8 the progress of the work and endeavor to protect the owner and HUD against defects and
9 deficiencies in the construction.
- 10 B. Reasons for termination of services. Inadequate performance, undue delay,
11 misrepresentation or failure to act on the part of the Architect or the Architect's
12 associates and employees shall be reason for the termination of the Architect's services on
13 the project and may adversely affect the firm's acceptability on future projects.
- 14 C. HUD office actions. The HUD inspector shall bring to the attention of the Architect
15 specific areas in which services are considered deficient. Sufficient time and appropriate
16 assistance shall be given to obtain necessary compliance.
- 17 1. When the Architect's performance is first observed as deficient, in addition to the
18 HUD Representative's Trip Report, Form HUD-95379, the inspector shall also
19 prepare a written memorandum to the CM of the deficiency and advice of any
20 planned actions or assistance. The memorandum should recommend that future
21 requests for Architectural inspection fees be disallowed until performance improves
22 to an acceptable level.
- 23 2. An immediate follow-up by the CM is always required. Conferences with the
24 inspector and the Architect should be arranged and a target date established for the
25 Architect to obtain compliance. The CM shall inform the Regional Center Director of
26 current problems and of established target dates for corrections. Deficiencies related
27 to misrepresentation, undisclosed identity of interest and known illegal kick-backs
28 should be immediately referred to the local HUD Office of General Counsel with a
29 copy to the Regional Center Director. The local HUD Office should clearly
30 document all actions.
- 31 D. Request for contract termination. When compliance with the contract cannot be obtained
32 within 30 days, the Regional Center Director shall request termination of the Architect's
33 contract in accordance with the provisions of the Owner-Architect Agreement. Upon
34 termination, the Architect shall be entitled to only the prescribed portion of the fee
35 determined by the percentage to which construction was completed on the date that the
36 Architect was removed from the project. The Regional Center Director has full authority
37 to secure acceptable performance.

- 1 E. Contract termination. The owner will hire an independent Architect who is acceptable to
2 all parties to continue the administration of the project construction documents. The HUD
3 inspector does not assume the Architect's responsibility.

4 **12.6 Completion Inspections**

- 5
6 A. Substantial completion. The Architect will date and sign the certification on Form
7 HUD-92485, Permission to Occupy, for that part or for all the work that is sufficiently
8 complete, in accordance with the contract documents, and may be occupied for the use
9 intended.

- 10 1. The contractor must submit a punch list of items to be completed or corrected to the
11 Architect when the work is ready for occupancy. (See Article 9.8, AIA Document
12 A201.)
- 13 2. The Architect will inspect, check the punch list and modify it if necessary, and
14 determine when the work is substantially complete. (Dwelling units containing punch
15 list items will not be accepted for occupancy. However, punch list items in interior
16 common areas and on the exterior do not preclude occupancy.)
- 17 3. Certificate of Substantial Completion: The HUD inspector will verify on Form HUD-
18 92485 the date that the work, or a portion of the work, is substantially complete and
19 suitable for occupancy. Where the Owner/Architect Agreement and the General
20 Conditions of the Construction Contract, AIA A201, refer to a Certificate of
21 Substantial Completion, it confirms that the Permission to Occupy Project Mortgages,
22 Form HUD-92485, was executed. The date of substantial completion of the project is
23 the date that the HUD Representative signs the Permission to Occupy for the final
24 building or for the portion of the work that is completed.
- 25 4. The Contractor's Guarantee Period commences with Substantial Completion of the
26 Project as defined in Article 3.B of the Construction Contract, HUD-92442M which
27 takes precedence over AIA A201, Article 9.8.4, and stipulate that warranties
28 commence with the substantial completion of each portion of the work.

- 29 B. Final completion inspection. The Architect and inspector will make the final inspection
30 upon written request of the contractor, and may do so separately.

- 31 1. The Architect must determine that all punch list items have been completed unless
32 they are beyond the control of the contractor (i.e.: items of delayed completion).

- 1 2. The inspector must prepare the final inspection report on Form HUD-95379 which
2 includes:
 - 3 a. Reports onsite construction completion, although there may be items of delayed
4 completion.
 - 5 b. Lists and describes any items of delayed completion.
 - 6 c. Lists any offsite work and reports the percentage of completion for each.
- 7 3. The HUD Construction Manager/Coordinator will check the final inspection report to
8 determine:
 - 9 a. If unacceptable and, requires re-inspection (i.e.: the report is not considered final).
 - 10 b. If acceptable, the report will be endorsed as follows:
 - 11 (1) "Construction acceptably completed." (If there are items of delayed
12 completion, add, "subject to escrow of funds to assure completion of listed
13 items of delayed completion.")
 - 14 (2) "All offsite sewer, water, electrical and gas facilities are completed,
15 connected and operable, and safe, adequate, all-weather ingress and egress
16 provided." (If offsite item incomplete, add, "except as stated at the time of
17 inspection.")
 - 18 (3) Date and sign the report.
 - 19 c. CM will prepare a memorandum for signature by the Regional Center Director
20 transmitting the final inspection report, which:
 - 21 (1) States the date of final completion (i.e.: the date of final inspection);
 - 22 (2) Lists incomplete offsite work; and
 - 23 (3) Lists items of delayed completion and the estimated of cost of completion
24 for each item.
- 25 NOTE: The escrow for items of delayed completion must not be less than
26 150% of the estimate to complete and must not exceed 2% of the mortgage.
27 Work must be completed within the time specified in Form HUD-92456M,
28 Escrow Agreement for Incomplete Construction, but not more than 12 months
29 from the date of the final HUD inspector's trip report.
- 30 C. Guarantee inspections. Inspections to ensure correction of latent defects (defective or
31 nonconforming work not observed during construction) or to check any item of delayed
32 completion will generally not be required or expected. HUD has the option of requiring
33 such inspections on particular transactions. For those transactions where such inspections

1 are requested by HUD, they should be performed within 1 year of the date of final
2 completion and the following requirements will apply:

- 3 1. The CM/Coordinator will schedule guarantee inspections as follows:
 - 4 a. The first inspection must be within 9 months of final completion and should
5 provide for inspection of the entire project.
 - 6 b. Other inspections may be necessary to assure inspection of seasonal items such as
7 heating and landscaping.
 - 8 c. The last inspection must be not later than the 10th day of the 12th month to check
9 previously reported defects and their correction, and to identify any additional
10 defects.
- 11 2. The inspector must report each guarantee inspection on Form HUD-95379, including:
 - 12 a. If work is acceptable, state, "All observable work acceptable at the time of this
13 inspection."
 - 14 b. If unacceptable, list latent defects.
 - 15 (1) Describe each item.
 - 16 (2) Recommend method of correction.
 - 17 (3) Estimate current cost of correction.
 - 18 c. Check any item of delayed completion and list complete and uncompleted items
19 under a separate heading.
 - 20 d. Note any improper maintenance or casualty damage under a separate heading.

21 **12.7 Insurance of Advances and Related Matters**

22 A. General.

23 Insurance of advances is the process of releasing insured mortgage funds and other funds
24 necessary for the construction, acquisition and/or refinancing of the project. The following
25 general criteria apply to the advancing of such funds.

- 26 1. All escrowed funds for on-site improvements (with the possible exception of
27 grant/loan proceeds furnished by a government agency or instrumentality or tax credit
28 equity proceeds) must be disbursed before mortgage proceeds. See Section 8.10 for
29 instructions on grants/loans and tax credit equity and Appendix 12A for instructions
30 on the pro-rata disbursement of tax credit equity proceeds.
- 31 2. The amount of construction funds approved and advanced for insurance must be
32 consistent with construction progress as approved by the HUD Field Representative.

- 1 3. Other mortgageable items must be supported with proper bills and/or receipts before
2 funds can be approved and advanced for insurance.
- 3 4. The amount advanced for construction items must be adjusted for a 10% holdback
4 until 50% completion.
- 5 5. The final amount approved for insurance must be supported by certified costs
6 recognized in the cost certification review. Projects that are exempt from the cost
7 certification process can submit a copy of their final Sources and Uses Statement
8 prepared by the allocating State Housing Finance Agency for HUD's review of the
9 final sources and uses amounts.
- 10 6. The Application for Insurance of Advance of Mortgage Proceeds, Form HUD-92403,
11 is initiated by the mortgagor. The initial and final advances must be submitted by the
12 mortgagee to HUD for review and approval. Interim advances are approved by the
13 mortgagee, based upon the HUD inspectors' approval of the construction amount.
14 The approved Contract Administrator must sign forms HUD-92403 and HUD-92448
15 in the Authorized HUD Official signature block.
 - 16 a. For the initial and final advances, the PC Director must sign Forms HUD-92403
17 and HUD-92448, in the following spaces:
 - 18 (1) Under Authorized HUD Official for Form HUD-92403, and
 - 19 (2) Under Director, Housing Production for Form HUD-92448.
 - 20 b. For the interim advances, the lender (by either the lender's underwriter or
21 construction loan administrator) must sign Forms HUD-92403 and HUD-92448 for
22 HUD, in the same spaces as in 6.a (1) and (2) above.
- 23 7. Supporting materials to Form HUD-92403 include supporting bills/receipts and Form
24 HUD-92448, Contractor's Requisition, if requesting construction funds.
- 25 B. Lender's role in processing HUD-92403 includes:
 - 26 1. Complete the application indicating:
 - 27 a. Amount requested by mortgagor;
 - 28 b. Approximate disbursement date;
 - 29 c. Amount to be advanced from mortgage proceeds;
 - 30 d. Amount disbursed from mortgagee's front money escrow, if any; and
 - 31 e. Total loan proceeds disbursed including the current request.
 - 32 2. Submit the initial and final application to HUD for review and approval.
 - 33 3. Process and approve interim advances.
 - 34 4. Ensure clear title before advancing the approved disbursement.

1 5. Notify HUD in writing when clear title does not exist or is impaired.

2 C. Stages of Advances.

3 In cases involving insurance of advances, HUD and the lender's processing of the
4 advance is divided into the following stages:

5 1. Initial advance. Refers to the first application and coincides with the initial endorsement
6 of the mortgage. The initial advance will be reviewed and executed by the HUD
7 mortgage credit analyst. The lender should submit Form HUD-92403, Application for
8 Insurance of Advance of Mortgage Proceeds, with supporting documentation for HUD
9 approval.

10 2. Interim advances. Interim advances are subsequent applications up to completion of
11 the project and will be processed and approved by the lender.

12 3. Next to Final Advance. When HUD is in receipt of the contractor's certification and
13 of the consent from the mortgagor, and surety, if any, the final 5% of the construction
14 holdback is released.

15 Note: This procedure only applies to non-identity of interest contractors or where the
16 contractor's identity of interest in the project ownership is less than 5%.

17 4. Final Advance. This refers to any remaining balance of mortgage proceeds at final
18 endorsement and takes into consideration funds necessary to set up the escrows for
19 "Items of Delayed Completion" and "To Be Paid in Cash Items" and will be
20 processed by HUD. In addition to the Form HUD-92403, the lender must submit a
21 copy of Form HUD-92451 Financial Record of Mortgage Loan Transaction, which
22 reflects releases to the various payees during the construction period.

23 D. Instructions for Approval of Initial/Interim Advances can be found in Appendix 12A.

24 E. Contractor's Monthly Requisition and Related Matters. See Appendix 12B for
25 instructions on completing Contractor's Requisition, Form HUD-92448, and related
26 matters.

27 F. Next to Final Advance. The lender may request the final advance when construction is
28 acceptably complete, even if there are items of delayed completion.

29 1. It may provide for the release of the contractor's holdback provided the conditions in
30 Section 12.15.D have been met. The amount approved for release will be based on the
31 cost certification review and HUD-approved amount (or where the cost certification is
32 exempt, an operating statement is reviewed instead). The amount approved for release
33 will also consider items of delayed completion. A special condition will be included in
34 the firm commitment in the event that the cost certification is exempt and an operating
35 statement will be reviewed instead.

- 1 2. The balance of the off-site escrow may be released provided:
 - 2 a. The off-site sewer, water, electrical and gas facilities are completely installed and
 - 3 connected; and safe and adequate all weather facilities for ingress and egress are
 - 4 provided.
 - 5 b. All other required off-site construction, if any, is completed.
 - 6 c. Otherwise, completion is to be assured by a cash deposit in an amount equal to
 - 7 150 percent of the HUD estimate of the cost of such off-site construction.

8 G. Final Advance. The Application for Insurance of the Final Advance will request any
9 remaining balance of mortgage proceeds and ensures that:

- 10 1. The mortgagor's cost certification has been approved and the maximum insurable
11 mortgage amount determined using Form HUD-92580, Maximum Insurable
12 Mortgage.
- 13 2. Form HUD-92403 is accompanied by a completed Form HUD-92448, with required
14 Contractor's Prevailing Wage Certificate, if the contractor's holdback has not been
15 previously disbursed. Refer to Section 12.15.D for instructions on releasing the
16 contractor's holdback.
- 17 3. The sum to be approved for the advance is the balance of the mortgage proceeds,
18 based on the maximum insurable mortgage on Form HUD-92580. Refer to Section
19 13.12 for instructions on an advanced amortization adjustment, if any.
- 20 4. Set up the escrow under the provisions of Form HUD-92456M, Escrow Agreement
21 for Incomplete Construction (formally Escrow Deposit Agreement for items of
22 delayed completion).
- 23 5. Form HUD-92023M, Request for Final Endorsement of Credit Instrument, or Form
24 FHA-2453, Commitment to Insure upon Completion, must have been submitted and
25 reviewed.
- 26 6. Set-up the escrow for the mortgagor's unpaid construction costs under the provisions
27 of Form HUD-92476.1M, Escrow Agreement for Non-Critical, Deferred Repairs,
28 (formally Escrow Agreement for Unpaid Construction Costs, Repairs or Needs
29 Assessment Repairs).

30 H. Keeping the mortgage in balance.

31 Soft cost overruns such as interest, taxes, mortgagee insurance premium (MIP), and
32 insurance that result from a construction delay before completion of the project and
33 which is the fault of the general contractor, (i.e., due to poor performance), are funded
34 according to the liquidated/actual damages clause in the construction contract. This
35 clause is not intended to penalize the contractor, but to provide a source of funds for the
36 increased soft cost. When the interest allocation is near exhaustion (*i.e. when the balance*

1 after several draws is \$1,000 or less) the lender must notify HUD immediately. The
2 Architect and the HUD inspector must notify the lender of the following procedures:

- 3 1. When the interest allocation is near exhaustion, have the Architect and the HUD
4 inspector estimate an expected completion date.
 - 5 a. Compute the minimum liquidated damages for the period between the completion
6 date specified in the construction contract, as adjusted by approved change orders,
7 and the estimated completion date.
 - 8 b. When the interest allocation has been exhausted, the nonprofit developer's fee, if
9 applicable, or the working capital escrow should be used to keep interest current.
 - 10 c. Transfer the computed liquidated damages amount from column I, Construction,
11 to Column G, Carrying Charges and Financing, on Form HUD-92451 and:
 - 12 (1) Allocate the full amount to interest, initially.
 - 13 (2) Funds may be used for MIP, taxes, or insurance payments, if requested,
14 after the funds for these line items and nonprofit developer's fee, if
15 applicable and working capital escrow are exhausted. However, funds
16 transferred from the construction account may be used to cover only the
17 cost of those items attributable to the period in paragraph 1 above,
18 specified in the construction contract and the assumed completion date.
- 19 2. Notify the borrower, contractor, HUD and the surety, if any, by certified mail of the
20 amount and the reason for the transfer.
- 21 3. Require written acknowledgment from HUD and surety, if any, before transferring
22 funds.
- 23 4. The amount of transferred funds must be reflected on subsequent Forms HUD-92448
24 as a decrease to item 7, *Sum of Cost Breakdown Items Plus Inventories of Materials*.
- 25 5. After review of the cost certification documents, if the full amount of transferred
26 funds was not needed to cover the cost of interest, MIP, taxes, and insurance
27 attributable to the period identified, the balance will be transferred back to the
28 construction account.
- 29 6. In processing Form HUD-92448, before releasing the general contractor's holdback,
30 make adjustment for the lesser of actual or liquidated damages determined in the cost
31 certification review.
- 32 7. This procedure should be used only if, in consultation with the Regional Center
33 Director, it is determined that the problems causing the delay will be remedied within
34 the near future.

- 1 8. In the event the project continues to sustain an imbalance between sources and uses of
2 funds, the Regional Production Office will inform the Regional office of Asset
3 Management about the issues and the status of any release of IOD funds.
4

5 **12.8 Construction Change Orders – General HUD Duties**

6 A. General instructions. Construction contract changes to the scope of contract work, contract
7 price or contract time must be requested by the mortgagor through the lender on Form HUD-
8 92437, Request for Construction Changes and must be signed by the mortgagor’s Architect,
9 the mortgagor, the general contractor and the lender. HUD must approve the change order.

- 10 1. HUD review and approval. Each HUD discipline as appropriate, including
11 Architecture, Cost, Appraisal, Mortgage Credit and the HUD inspector must review
12 and make a recommendation to the HUD CM.
- 13 2. Change orders will be approved only when they are necessary, are for betterment or
14 an equivalent. The following information should appear on the face of the change
15 order:
- 16 a. Classification (necessity, etc.);
17 b. Qualification for payment from the contingency reserve and from the developer’s
18 fee for nonprofit borrowers; and
19 c. Whether the change order results from error, omission or negligence on the part of
20 the Architect, contractor or mortgagor.
- 21 3. Change orders submitted after the final HUD Representative’s Trip Report will not be
22 approved, except where:
- 23 a. The change order pertains to “Items of Delayed Completion,” or
24 b. Written approval is given by the Regional Center Director.
- 25 4. Surety approval must be secured in writing before approving any change or aggregate of
26 changes that increase the contract price by 10% or more. Surety consent is not required
27 where the project’s assurance of completion is by a cash escrow or letter of credit.
- 28 5. Working capital construction contingency. The working capital escrow requirement
29 for new construction transactions is 4% of the mortgage amount, half of which (or
30 2%) is a construction contingency to be used to fund “necessary” approved change
31 orders, construction cost overruns and other cost overruns. The 2% construction
32 contingency portion of the escrow will be refunded to the developer after Final
33 Endorsement, if not used. .

34 B. Other change order policies.

- 1 1. Changes must be accurately reported and accounted for pursuant to U.S. Criminal
2 Code, Section 1010, Title 18, U.S.C.
- 3 2. Procedures for changes outlined here are not to be used to alter the intent of the
4 contract documents or to lower the quality or value of a project.
- 5 3. HUD does not initiate any change but may require it as a condition of approval in
6 connection with a change proposed by the Architect, mortgagor or contractor.
- 7 4. All changes must be approved in writing by the lender and HUD before they are
8 made.
- 9 5. Any change that is made without formal approval, even though tentatively agreed to
10 as technically acceptable, must be recorded by the HUD inspector as a
11 noncompliance until the Form HUD-92437, Request for Construction
12 Changes - Project Mortgages, is approved, and it will also affect payment of
13 advances.
- 14 C. Change order classification.
 - 15 1. Necessary changes (which the Construction manager or architectural designee must
16 document) are those that arise from:
 - 17 a. Latent conditions that differ from conditions defined by the construction
18 documents;
 - 19 b. Changes in the applicable state or local codes, ordinances, etc. after:
 - 20 (1) Initial closing for insured advances; or
 - 21 (2) Firm Commitment for insurance upon completion.
 - 22 c. The Architect's errors or omissions.
 - 23 d. Damage to completed construction.
 - 24 2. Betterment changes are those that are economically justified. They must either:
 - 25 a. Increase net income;
 - 26 b. Reduce long-term project maintenance and/or operating expenses; or
 - 27 c. Otherwise enhance the mortgage security.
 - 28 3. Equivalent changes are those proposed because:
 - 29 a. A specified item is not readily available and the substitution provides equivalent
30 or better utility and performance, or
 - 31 b. The proposed substitution reduces the contract price but provides equivalent or
32 better utility and performance.

- 1 D. Additive change orders. The lender must not give any explicit or implied assurance to the
2 mortgagor or the contractor that an increase in the insured mortgage amount will be
3 granted when construction changes are approved.
- 4 1. Lender must require the mortgagor, except for “necessary” change orders on substantial
5 rehabilitation projects, to escrow funds with the lender for any additive change order
6 where HUD first estimates that the aggregated change orders equal or exceed a \$5,000
7 increase in the construction contract price, and for all subsequent additive change orders.
8 Nonprofit mortgagors may use the Developer’s fee to fund additive change orders.
- 9 a. Excess mortgage proceeds, if available, may be used to fund the escrow for
10 “necessary” and “betterment” change orders. However, any excess mortgage proceeds
11 used to fund the escrow for contractor estimated costs in excess of HUD estimated
12 costs, or HUD estimated costs in excess of contractor estimated costs, may not be
13 disbursed until final closing.
- 14 b. The lender may accept a third party letter of credit instead of a cash deposit,
15 subject to the lender agreeing to provide the cash equivalent, where the letter of
16 credit is not immediately honored.
- 17 c. The lender may recognize the cost of third party paid change orders at cost
18 certification, where there are available mortgage savings.
- 19 2. For substantial rehabilitation projects the lender must approve disbursements from the
20 established contingency reserve in an amount not to exceed the HUD cost estimate for
21 “necessary” or betterment change orders.
- 22 a. The lender must require an escrow for any amount that the contractor’s cost
23 estimate exceeds the HUD estimate.
- 24 b. The lender may authorize the use of excess mortgage proceeds, if available, to satisfy
25 the escrow requirement, subject to the disbursement limitations in paragraph
26 12.8.D.1.a above.
- 27 c. After substantial rehabilitation work is complete and approved by the HUD inspector
28 and subject to lender and HUD approval, the borrower may elect to apply funds
29 remaining in the construction contingency account to:
- 30 i. necessary, further improvements, betterments or upgrades to the property,
31 ii. an initial deposit to the Reserve for Replacement account, or
32 iii. reducing the principal mortgage balance.
- 33 3. The lender must approve the following forms for mortgagor’s application of funds for
34 completed additive change orders:
- 35 a. Form HUD-92464M, Request for Approval of Advance of Escrow Funds, where
36 an escrow is used, which must be submitted to HUD for approval.

- 1 b. Form HUD-92403, Application for Insurance of Advance of Mortgage Proceeds,
2 where a rehabilitation project's contingency funds or a nonprofit's Developer's
3 fee or excess mortgage proceeds are to be used.
- 4 E. Deductive change orders. Where the HUD estimated decrease in contract price for any
5 aggregation of change orders:
 - 6 1. Remains less than 2-1/2% of the contract price, the lender must reduce the
7 Contractor's "Final" Requisition, Form HUD-92448, by the appropriate amount.
 - 8 2. Equals or exceeds 2-1/2% of the contract price and for all subsequent deductive
9 change orders regardless of the amount, the lender must:
 - 10 a. Reflect the decrease in the Contractor's Requisition, Form HUD-92448, item 8.
 - 11 b. Reduce the original mortgage amount at cost certification, where required.
- 12 F. Changes that adversely affect property income are a basis for change order rejection,
13 except where it is a necessary change order and the situation is unavoidable.
- 14 G. Extension of contract time.
 - 15 1. The lender may approve an extension only where:
 - 16 a. The delay is beyond the contractor's control (e.g. strikes, differing site conditions,
17 bad weather exceeding the average for the season, etc.) and it is documented or
18 associated with an approved change order,
 - 19 b. The extension request is submitted within the limit provided by the contract and
20 the general conditions for delays beyond the contractor's control, and submitted
21 concurrently with any requested changes in the work, and
 - 22 c. The request is accompanied by a Surety's written consent. There is no consent
23 requirement where the project's assurance of completion is by a cash escrow or letter
24 of credit.
 - 25 2. The lender may require funding for the increased cost for overhead, interest, taxes,
26 insurance, MIP and contractor's general requirements by use of a cash escrow, excess
27 mortgage proceeds, or nonprofit's developer's fee, if applicable, or from contingency
28 reserve.
 - 29 3. HUD may enforce liquidated damages in accordance with the contract.
 - 30 4. Required documentation. Within 21 days of the date a construction delay occurs, the
31 contractor must document it with the Architect and include:
 - 32 a. Date of occurrence and number of calendar days it covered;
 - 33 b. Effect on construction progress;

- 1 c. Cause of the delay. If the cause is of a continuing nature, submit the extension request
2 when the cause ceases, but still record the initial date of occurrence and its effects on
3 construction; and
- 4 d. The extension request must include the written consent of the Surety and conform
5 to AIA Document A201, Article 8.3.
- 6 H. Changes to items of delayed completion are the only construction contract changes that the
7 HUD Representative may approve after project completion. All others require the Regional
8 Center Director's consent.
- 9 I. Emergency changes.
- 10 The only time a change can be made without prior written approval of the lender and
11 HUD is in emergencies that:
- 12 a. Endanger life or property; or
13 b. Halt construction.
- 14 However, even then, the Architect must notify the lender and HUD and as soon as
15 possible, submit a Form HUD-92437.
- 16 J. Insurance Upon Completion: Construction Contract Changes, Form HUD-92437, are to
17 be processed in the same way as Insurance of Advance cases, except as modified below:
- 18 1. An escrow is not required for additive change orders. The borrower:
19 a. Must be able to provide the additional funds required, and,
20 b. Must not have any outstanding obligation in connection with construction other
21 than the insured mortgage at the time the mortgage is presented to HUD for
22 insurance upon completion.
- 23 2. Surety approval is not required for the approval of additive change orders regardless
24 of the percentage of contract increase.
- 25 K. Changes to offsite construction must be requested by letter or other acceptable format
26 with the information required by Form HUD-92437 used as a general guide, although the
27 actual form must not be used.
- 28 L. Other changes. Changes necessitated by error, omission or negligence of the Architect, owner,
29 or contractor must be recorded by the HUD architectural staff or inspector, on Form
30 HUD-92437, including.
- 31 1. The reason for the determination; and
32 2. Confirmation that the cost of the changes must not be included in the mortgage
33 amount.

12.9 Change Orders – Inspection Instructions

A. General procedure.

NOTE: For projects involving insurance upon completion, references here to "contract requirements" or "contract documents" include the conditions and provisions of the commitment if there is no construction contract.

1. Any contemplated changes are first discussed among the Architect, contractor, owner, and HUD inspector.
2. HUD inspector will make a preliminary determination of technical acceptability before the change is submitted for approval to the lender and the HUD Office. (This neither commits HUD to the change, nor relieves the Architect or the contractor of having to submit Form HUD-92437.)
3. All onsite changes to construction documents and requests for time extensions must be submitted for approval on Form HUD-92437, Request for Construction Changes - Project Mortgages.
 - a. Required attachments for physical changes are:
 - (1) Appropriate modifications to the contract drawings and specifications;
 - (2) Architect's statement that the change:
 - (a) Conforms to the original intent of the contract drawings and specifications;
 - (b) Is necessary to overcome an impediment to construction, or is an addition desired by the owner.
 - (3) Backup documentation for the amount requested consisting of itemized quantities and costs.
 - b. The form must be signed by the:
 - (1) Borrower,
 - (2) Contractor,
 - (3) Architect (if an Owner-Architect Agreement is in effect), and
 - (4) Authorized official for the lender.

- 1 4. All offsite changes to construction documents and requests for time extensions must
2 be:
 - 3 a. Requested in a letter or other format acceptable to the Regional Center/PC, but
4 not on Form HUD-92437.
 - 5 b. Documented and processed the same as on-site changes.
- 6 5. HUD will promptly review all requests submitted so delays will not affect
7 construction or contractor requisitions
 - 8 a. Processing should normally take no more than 5 workdays and is directed by the
9 CM.
 - 10 b. All construction change requests must be reviewed, signed, and dated by the CM.
- 11 6. Voiding changes. If an approved change is not made, it must be nullified by a Form
12 HUD-92437 restoring the drawings and specifications to the status prior to the change
13 request or to a status acceptable to HUD.
- 14 7. Unapproved changes. When there are unapproved changes in the construction, the
15 HUD inspector must modify the amount of the contractor's requisition to cover:
 - 16 a. The non-compliance (any change that has not formally been approved on Form
17 HUD-92437), and
 - 18 b. Construction removal that may be required if the unapproved change does not receive
19 approval.

20 **12.10 Change Orders – HUD Architectural and Cost** 21 **Instructions**

- 22 A. Architectural. The HUD construction analyst will review all requested changes for
23 technical acceptability.
- 24 B. Cost.
 - 25 1. Construction changes:
 - 26 a. The HUD cost estimator will produce a cost estimate for each construction change
27 request submitted by the mortgagor by applying current data to accepted or amended
28 change order quantities; include amounts for general requirements and builder's
29 overhead and profit using the percentage of each from Section G of Form HUD-
30 92264 that was approved at Firm review.
 - 31 b. Compare the estimate with the mortgagor's estimate and, if reasonable, use the
32 mortgagor's figure. Otherwise use the HUD estimate.
 - 33 c. Complete the cost entries on Form HUD-92437 and forward the completed form
34 to the HUD mortgage credit examiner and/or the appraiser, if applicable.

- 1 2. Approved time extensions:
- 2 a. Calculate the additional general requirements cost due to the extension of time.
- 3 (1) Divide the cost of general requirements from the contractor's approved
- 4 Form HUD-2328 by the number of months estimated for construction from
- 5 Section G of Form HUD-92264 approved at Firm commitment. Sixty-five
- 6 percent of this amount is the estimate per month of additional general
- 7 requirements.
- 8 (2) Use one quarter of the monthly estimate per week.
- 9 (3) There is no cost effect for extensions of time for less than one week.
- 10 b. Complete the cost entries on Form HUD-92437 and forward the completed form
- 11 to the HUD appraiser and mortgage credit examiner.

12.11 Change Orders – HUD Appraisal and Mortgage Credit Instructions

A. Appraisal.

1. The HUD appraisal staff must review all requested changes that may affect marketability, value, income, or maintenance or operating cost; and identify and explain any estimated increase or decrease in net project income on the reverse of Form HUD-92437.
2. The HUD appraiser must forward a Trial Form HUD-92264 and Trial Form HUD-92264-A reflecting the new data for Mortgage Credit re-determination of the maximum insurable mortgage.

B. Mortgage credit.

1. Processing.
 - a. If the borrower's or contractor's estimate for the change order exceeds HUD's estimate, the difference must be escrowed with the lender. Excess mortgage proceeds, if available, may be used to satisfy this requirement. Conversely, that portion of HUD's estimate which exceeds the borrower's or contractor's estimate must be restricted and held until final endorsement to ensure funds to complete the project.
 - b. Process the cost and appraisal findings and show the cumulative effect on cost of all approved change items.
 - c. Use Sections 12.8.D and 12.8.E for additive and deductive change orders.

- 1 d. Recalculate the maximum insurable mortgage when any approved construction
2 change or changes adversely affect net income, e.g., a change that causes an
3 increase in project operating costs or a reduction in project income.
- 4 (1) Appraisal completes a Trial Form HUD-92264 with an updated income
5 and expense analysis.
- 6 (2) Re-determine the maximum insurable mortgage.
- 7 (3) If the re-determined mortgage is lower than the original mortgage amount,
8 as a condition of approval of the change order, indicate in item 3b of Form
9 HUD-92437 that subsequent Contractor's Requisitions, Form HUD-
10 92448, must be reduced by the greater of:
- 11 (a) The difference in mortgage amounts;
- 12 (b) The net increase in costs resulting from acceptable construction
13 changes.
- 14 e. Extensions of time.
- 15 (1) Architectural and cost technicians are responsible for determining whether
16 the delay was beyond the contractor's control and, if so, the length of the
17 approved time extension.
- 18 (2) Calculate the cost increase due to the extension:
- 19 (a) Compute daily rate for interest, taxes and insurance by using
20 estimates in Section G of Form HUD-92264 and multiply these
21 rates by the approved time extension.
- 22 (b) An additional year of MIP will be required if the approved time
23 extend, when added to the estimated construction term plus the
24 2 months included in Section G of Form HUD-92264; plus
25 previously approved time extensions.
- 26 (c) Add the additional general requirements, if any, noted by the Cost
27 branch on the change order request.
- 28 **NOTE:** Only Item (c) above amends the construction contract price on Form
29 HUD-92437.
- 30 (3) Determine the source of funds for any increase due to the extension, i.e.,
31 cash, excess mortgage proceeds or nonprofit's developer fee, or
32 contingency reserve funds.
- 33 (4) Requests for release of excess mortgage proceeds or contingency reserve
34 funds set aside to fund time extensions are submitted on Form HUD-
35 92403.

- 1 (5) Releases from a cash deposit are made using Form HUD-92464M.
- 2 (6) These funds may be released only after the account for the soft cost
- 3 item(s) being requested has been exhausted on Form HUD-92451,
- 4 Financial Record of Mortgage Loan Transaction.
- 5 2. Requests for disbursement of contingency reserve funds, working capital construction
- 6 contingency funds and nonprofit's developer fee for completed change order items
- 7 are made on Form HUD-92403. All requests:
 - 8 a. Must be accompanied by a certification by the borrower's supervisory Architect
 - 9 and the HUD Inspector that all the work covered by the change order has been
 - 10 acceptably completed in accordance with contract documents.
 - 11 b. Must include the borrower/borrower's certification relative to payment to the
 - 12 contractor contained on Form HUD-92464M, Request for Approval of Advance
 - 13 of Escrow Funds.
 - 14 c. Must include the criminal certification contained on Form HUD-92464M for
 - 15 certifications made in paragraphs a and b above.
 - 16 d. Are subject to a 10 % holdback.
- 17 3. Change orders funded from excess mortgage proceeds. Excess mortgage proceeds
- 18 may be used to fund either necessary or betterment change orders.
 - 19 a. These funds may be used to fund HUD's estimate of increased costs as well
 - 20 as any portion of the contractor's estimate which exceeds the HUD estimate.
 - 21 The portion which exceeds HUD's estimate must be restricted until final
 - 22 endorsement.
 - 23 b. Funds are released in the same manner as contingency reserve funds.
- 24 4. Releasing Cash Deposit. The borrower must submit, through the lender, Form
- 25 HUD-92464M when construction covered by a cash deposit is complete and
- 26 acceptable to HUD.
 - 27 a. The borrower's supervisory Architect and the HUD inspector must certify on
 - 28 Form HUD-92464M that all work and materials covered by the change order are
 - 29 satisfactory and consistent with contract drawings.
 - 30 b. If construction costs were paid in full with other than the cash escrow or
 - 31 excess mortgage proceeds before submitting the disbursement request to HUD
 - 32 for approval, the borrower must submit a receipt of payment signed by the
 - 33 general contractor.
 - 34 c. If construction costs will be paid after HUD's approval for the release of the
 - 35 funds deposited for the construction change, before the next Form HUD-92403

1 is submitted, the borrower must submit a receipt of payment signed by the
2 general contractor.

3 5. Change Order Summary Sheet showing cumulative cost of all executed change orders
4 should contain, at least:

- 5 a. The date the change order was signed by the borrower;
- 6 b. The date HUD received the change order;
- 7 c. The date the Mortgage Credit branch processed the change order;
- 8 d. The borrower's or contractor's estimate of cost for the change order;
- 9 e. HUD's estimate of cost for the change order;
- 10 f. The amount of change orders to be funded from contingency reserve, working
11 capital construction contingency, nonprofit's developer fee, or excess mortgage
12 proceeds;
- 13 g. The required cash escrow deposit, if any;
- 14 h. The HUD percentage of cost increase or decrease.

15 **12.12 Labor and Fair Housing and Equal Opportunity (FHEO)**

16 A. Wages

- 17 1. Payrolls. Contractor payrolls are submitted directly to the HUD Labor Relations staff
18 a minimum of once a month.
- 19 2. On-site interviews. The HUD Construction Manager forwards all original copies of
20 Form HUD-11, Record of Employee Interview, which are submitted by the HUD
21 inspector to the HUD Labor Relations Staff.

22 B. Labor violations. Advise the Labor Relations Staff of continuing minor infractions that
23 cannot be resolved or of any identified or suspected major violations.

24 C. FHEO noncompliance. Advise the local HUD Director of FHEO of continuing minor
25 noncompliance that cannot be resolved or of any identified or suspected major
26 noncompliance.

27
28
29

12.13 Surveys

Surveys must be by a licensed surveyor and show the exact location of on-site improvements, including utility lines and easements.

A. The contractor must give the owner and HUD surveys:

1. At any time the owner or HUD requires, and
2. When construction is complete (“as-built” survey).

B. The inspector, when uncertain of the location of construction or stored materials in relation to property lines or easements, may ask the Architect to require a survey with the next contractor's requisition.

C. If encroachments are found, the inspector must notify the HUD Construction Manager by memorandum explaining the conditions. (Encroachments may jeopardize the entire property as security for an insured mortgage.)

12.14 Permission to Occupy

Permission to Occupy Form HUD-92485 must be executed by HUD before the borrower permits occupancy of any dwelling unit.

A. Physical completion. The work, or portion thereof for which Permission to Occupy is approved, must be sufficiently complete in accordance with the contract documents so the mortgagor can occupy or utilize the identified portion of the work for its intended use.

1. Support facilities (utilities, disability access, vehicular access and parking, fire life-safety equipment, etc.) must be in place.
2. The acceptability of each unit and facility for which Permission to Occupy is requested must be confirmed:
 - a. Property must be inspected and Form HUD-92485 signed by the borrower, supervisory Architect, contractor, and HUD Representative.
 - b. Minor items that do not preclude occupancy are permitted but must be listed as an attachment to Form HUD-92485.
 - a. The contractor is fully responsible for any incomplete or improperly performed contract work whether or not listed.

1 B. Signatures, Approval and Permission:

- 2 1. Form HUD-92485 must be signed by the borrower, supervisory Architect,
3 contractor, lender, and HUD representative.
- 4 2. Approval: The Construction Coordinator or a designated MAP staff person in the
5 Program Center signs as Chief, Architecture and Engineering Section. The MAP
6 Team Leader signs as Chief Underwriter.
- 7 3. Permission to Occupy: The Regional Center Director and MAP Coordinator will
8 designate an FHA Authorized Agent in the Regional Center or PC to sign the
9 Permission to Occupy.

10 C. Submission Documents. The lender must sign Form HUD-92485 agreeing with the request
11 and stating that insurance risks have been covered for the project. The borrower must
12 include the following documents with the completed Form HUD-92485:

- 13 1. A Certificate of Occupancy or equivalent permit from the governing municipal
14 authority for all units and facilities listed on the Permission to Occupy; and any other
15 required permits or authorizations;
- 16 2. A certificate of property insurance from the borrower's insurance company.

17 D. Partial Occupancy Approval.

- 18 1. Favorably consider partial occupancy of units as they become available, where vandalism
19 could be minimized, needed project income is provided, an earlier rent-up date could be
20 achieved, utility costs for occupied units can be metered separately from contractor's
21 utilities, etc.
- 22 2. Approve a series of Permissions to Occupy as units or facilities become available, e.g.
23 individual buildings on multi-building projects, or individual floors or wings on larger
24 buildings.
- 25 3. Approve a single Permission to Occupy for all units where dictated by management
26 considerations, e.g. very small projects.

27 **12.15 Escrowed Funds, Letters of Credit, Deposits, Holdbacks**
28 **and Related Matters**

29 A. Borrower's Application for Escrowed Funds, for HUD approval.

1 Form HUD-92464M, Request for Approval of Advance of Escrow Funds, must be used
2 where the escrow is to ensure completion of offsite improvements, additive change orders,
3 non-critical repairs (under the Section 223(f) program), or borrower's unpaid construction
4 items at final endorsement.

- 5 1. The borrower must initiate filling out Form HUD-92464M and be completed by the
6 lender before the lender submits the disbursement request to HUD for approval.
- 7 2. The HUD inspector is required to record the percentage of acceptably completed
8 escrow work on the HUD Representative's Trip Report, Form HUD-95379. The
9 borrower will review the Trip Report to determine the amount of funds to request for
10 release of escrow funds that align with the completed work. After the borrower has
11 reviewed the Trip Report and entered information on the HUD-92464M, the borrower
12 must forward a copy of both Forms to the lender for their review and completion of
13 Form HUD-92464M for the disbursement request.
- 14 3. Do not authorize advances that exceed the documented percentage of completion, less
15 previous payments and a 10% retainage, until work is at 50% complete, after which
16 reduce the retainage to 5% until 75% completion, at which point retainage may be
17 released to 2.5% until the loan reaches Final Endorsement. (This does not apply to
18 Section 223(f) or Section 223(a)(7) loans.)
- 19 4. Where excess mortgage proceeds are used to fund an escrow for completion of offsite
20 improvements, additive change orders or mortgagor's unpaid construction items,
21 return the original copy of Form HUD-92464M to the depositor and retain one copy.

22 B. Release of letters of credit. In the event of a claim:

- 23 1. Assignment. HUD will not accept an assignment of the letter of credit to HUD from the
24 lender.
- 25 2. Un-drawn Balance. HUD will treat any un-drawn balance from a letter of credit or
26 escrow agreement as cash held by the lender.
- 27 3. Cash equivalent. The lender must provide cash equal to the un-drawn balance, if
28 demand on a letter of credit is not met.

29 C. Working Capital Deposit (HUD-92412M) escrow is established at initial closing with the
30 lender. It is the responsibility of the borrower to advise the lender how it plans to fund
31 the escrow either by cash, a letter of credit, excess mortgage proceeds, or excess land
32 equity, if any.

- 33 1. Purpose. The deposit is used to:
 - 34 a. Defray the cost of initial marketing and rent-up including: sales and advertising,
35 model furnishing, and equipment and supplies essential to initial rent-up, etc.

- 1 b. Cover project expenses during the first operating year that project income is not
2 expected to cover, including: real estate taxes, permanent property insurance
3 premiums, mortgage insurance premium, ground rents and assessments.
- 4 c. Cover shortfalls in interest, taxes, property insurance premiums, mortgage
5 insurance premiums, ground rents and assessments during construction after funds
6 available under the Building Loan Agreement are exhausted.
- 7 d. The new construction contingency portion of the escrow will be used for change
8 orders and cost overruns.
- 9 2. Control and Release of Escrow. The lender controls disbursements from the escrow,
10 except where the borrower certifies at firm commitment that any balance of the
11 escrow will be applied to the reserve for replacements or additional betterments on a
12 tax credit project. In reviewing a mortgagor's request for release of part of the
13 escrow, the following must be considered:
 - 14 a. Borrower's request for the release of such escrow funds must be by letter to the
15 lender, rather than on Form HUD-92403.
 - 16 b. None of the escrow can be used to defray any of the hard costs of construction
17 applicable to the Total for All Improvements, Section G of Form HUD-92264,
18 Rental Housing Project Income Analysis and Appraisal (or other Firm Stage
19 underwriting form applicable to the Section of Act the project is to be insured
20 under).
 - 21 c. Avoid premature disbursements and unnecessary expenditures.
 - 22 d. As portions of a project are ready for occupancy, a partial disbursement may be
23 permitted for reasonable opening expenses: however, it must be determined that
24 the escrow is not exhausted before the entire project is complete.
 - 25 e. The Field Office may direct that the deposit be used to cover any shortfall in
26 interest, taxes, property insurance mortgage insurance premiums, ground rent and
27 assessments.
 - 28 f. Fully document all expenditures from the escrow.
- 29 3. Final Release of Escrow.
 - 30 a. The lender may release any unused balance in the working capital escrow, subject
31 to HUD approval, to the mortgagor one year after Final Endorsement where the
32 project is not in default and when the operations of the project have demonstrated
33 to the Regional Center/PC's satisfaction that the project has achieved 6
34 consecutive months of break-even occupancy. Break-even occupancy is defined
35 as 1.0 debt service coverage, based on all sources of project income including
36 ancillary income

- 1 b. The lender must hold this escrow until any project financial problems are resolved
2 (e.g., has not reached sustaining occupancy, has poor liquidity or high payables, is
3 operating at a deficit or is near default).
- 4 c. If the mortgage is in default, the lender must apply any balance of the working
5 capital escrow to cure a default, where a default occurs before its release.
- 6 d. The borrower will receive a refund of the working capital new construction
7 contingency at final endorsement, subject to HUD approval and after any issues
8 discussed in paragraph a, b, and c, above are resolved or in the event the escrow is
9 not used.
- 10 D. Amount of contractor's retainage and release. The retainage provides an incentive for the
11 general contractor and mortgagor to promptly complete the project, submit cost
12 certification and reach final closing.
- 13 1. Amount of retainage. The Building Loan Agreement allows for the possibility of a
14 reduced holdback amount as set forth in a Retainage Reduction Rider when the
15 project reaches 50% completion. The construction contract also provides for a 10%
16 holdback from the contractor's monthly payments for acceptably completed work,
17 acceptably stored materials, and where applicable, components acceptably stored
18 offsite. The requirements for reduction of the retainage after 50% completion are as
19 follows:
- 20 a. The Contractor has no identity-of-interest with the owner that is greater than a 5%
21 equity interest in the ownership entity,
- 22 b. If applicable, prior written consent from the Surety must be obtained and attached
23 to the request for reduction, and
- 24 c. There can be no questions regarding the contractor's performance concerning the
25 quality of work, compliance with the contract and with any change orders or work
26 in progress. The Regional Center or PC Director must make the decision to
27 reduce the retainage based on the recommendation of HUD's construction
28 inspector.
- 29 d. Assuming the above conditions are met, the existing standard of 10% retainage
30 will be required only until 50% completion. After 50% completion, the retainage
31 may be reduced to 5% until 75% completion, and then may be reduced to 2.5%
32 retainage until the loan reaches Final Endorsement.

- 1 2. Release of retainage for identity of interest contractors. Except as provided in paragraphs
2 4 and 5 below, the retainage may not be released, in whole or in part, until Final
3 Endorsement for a contractor with an identity of interest.
- 4 3. Release of retainage for non-identity of interest contractor. The contractor's retainage, or
5 the remaining balance in the retainage, may be released at the next to last advance, when
6 requisitioned on Form HUD-92403, Application for Insurance of Advance of Mortgage
7 Proceeds, and subject to compliance with the following:
 - 8 a. Contractor's cost certification, where required, has been reviewed and necessary
9 adjustments made to Form HUD-92451, Financial Record and Mortgage Loan
10 Transaction;
 - 11 b. Contractor has disclosed its final obligations on Form HUD-92023M, Request for
12 Final Endorsement of the Credit Instrument;
 - 13 c. All work under the construction contract has been inspected and approved by the
14 controlling jurisdictions and/or authorities;
 - 15 d. Certificates of occupancy or other required approvals for the dwelling units and
16 non-dwelling facilities, where applicable, have been issued by governmental
17 authorities having jurisdiction. (Separate buildings for community rooms, rental
18 offices, laundry rooms, etc., commonly require separate certificates of
19 occupancy.);
 - 20 e. Permission To Occupy, Form HUD-92485 has been issued by HUD for all units;
 - 21 f. All Davis-Bacon payroll requirements have been satisfied;
 - 22 g. Surveyor's Certificate, Form HUD-92457M, and survey showing the location of
23 all improvements, utility easements and site utility distribution lines have been
24 submitted to HUD, and
 - 25 h. Retain, where applicable, an adequate amount to cover the following:
 - 26 (1) Items of delayed completion in an amount equal to 150% of the HUD
27 representative's cost estimate for completion,
 - 28 (2) Any owed or contested amounts indicated by mechanics, subcontractor,
29 supplier, or equipment lessor liens, etc.
 - 30 (3) The lesser of the liquidated damages or actual damages computed at cost
31 certification, and
 - 32 (4) The net effect of any negative change orders.
- 33 4. Early partial release of retainage.

- 1 a. After 90% contract completion, the Regional Center Director may release part of the
2 contractor's retainage and suspend further withholding of retainage from payments
3 due, where:
 - 4 (1) The contractor has no identity of interest or the contractor's only identity
5 of interest in the project ownership is less than 5%;
 - 6 (2) The contractor, mortgagor and mortgagee request the early release of the
7 holdback and attach the request to Form HUD-92403, Application for
8 Insurance of Advance of Mortgage Proceeds; and
 - 9 (3) Prior written consent from the surety, if any, for the early release of
10 holdback is provided with the request.
- 11 b. The Regional Center Director determines that:
 - 12 (1) The contractor's general performance warrants partial release of the
13 holdback without conditions, or
 - 14 (2) A partial release of the holdback is appropriate with conditions, e.g.,
15 measures to assure immediate distributions to subcontractors or others,
16 would be in the mutual interest of all participants, and
- 17 c. The un-disbursed holdback amount must equal or exceed 5% of the contract
18 amount.
- 19 5. Projects in difficulty. Release of part of the contractor's holdback before 90% contract
20 completion may be granted only to prevent a default of the construction loan and only if
21 it would solve the project's problems and enable it to reach construction completion.
 - 22 a. The contractor's performance must be considered, including:
 - 23 (1) The completed work must be satisfactory,
 - 24 (2) The percentage of completed contract work must be sufficient to ensure
25 project completion within the specified contract time, and
 - 26 (3) The holdback may not be released if there are serious, unresolved
27 questions concerning:
 - 28 (a) Quality of work,
 - 29 (b) Compliance with the contract, including outstanding change
30 orders, or
 - 31 (c) Work is progressing behind the contractor's construction schedule,
32 as amended by approved change orders.
 - 33 b. Written consent for the early release of holdback must be obtained from the
34 surety, if any, the mortgagor and the mortgagee.

1 E. Initial Operating Deficit Deposit must be established with the lender at initial closing and
2 may be funded by cash, a letter of credit, or excess mortgage proceeds, or excess land
3 equity, if any.

4 1. The operating deficit escrow provides funding for operating expenses and debt
5 service when net income is not available during the initial lease up period. This
6 escrow is not mortgageable and the unused portion must be returned to the borrower.

7 2. Release of the Initial Operating Deficit Escrow. HUD will consider lender's request
8 using Form HUD-92476.a-M, Escrow Agreement for Operating Deficit, for all initial
9 operating deficit draws during lease-up. The lender's request must be accompanied
10 by:

11 a. A review and analysis of the monthly accounting reports detailing progress on
12 lease up as compared to the lease up projections used in underwriting, and

13 b. An updated calculation of the sufficiency of the escrow. This analysis and
14 calculation is particularly important if the project is experiencing substantial
15 variations from its lease up projections.

16 c. Unused amounts will be released upon the lender's request at the later of 12
17 months after Final Endorsement or when the project has demonstrated to the HUD
18 field office's satisfaction that the project has achieved 6 consecutive months of
19 break-even occupancy. (Break-even occupancy is defined as 1.0 debt service
20 coverage, based on all sources of project income including ancillary income.)
21 HUD Mortgage Credit staff will consult with Asset Management (AM) staff prior
22 to approval of a release to obtain AM's approve of the release. Regional
23 Centers/PCs should exercise caution to be certain that monthly results are not
24 erratic or seasonal and that 1.0 or better debt service coverage will be sustainable
25 after release of the escrow funds. For garden apartment projects consisting of
26 separate buildings, each of which is leased up separately, HUD will consider
27 partial releases of the operating deficit escrow as individual buildings achieve 6
28 consecutive months of break-even occupancy. The lender is responsible for
29 insuring that escrow funds are released solely for project operating needs.

30 F. Cash-Out Escrow From Land Equity or (any balance remaining after capitalizing the
31 escrow.) See Section 8.16.

32 1. Cash out from the excess value of the land, or the "as is" property value for a
33 substantial rehabilitation project, that was contributed to meet the sponsor's equity
34 requirement at initial endorsement, **above** what was required at initial endorsement
35 must be deferred and held by the lender. If any of the land equity was used to fund
36 escrows at initial endorsement, the remaining balance is deferred and held by the
37 lender. The lender will have discretion as to the form of escrow to use to hold back

- 1 any cash-out from land equity. Refer to Appendix 12A paragraph E about eligible
2 uses of equity before the escrow is held by the lender.
- 3 2. The lender will hold the cash out funds until project operations have demonstrated to
4 the HUD field office's satisfaction that it has achieved 6 consecutive months of
5 break-even occupancy or 12 months break-even occupancy for transactions that meet
6 the Large Loan parameters. (Break-even occupancy is defined as 1.0 debt service
7 coverage, based on all sources of project income including ancillary income.) HUD
8 Mortgage Credit staff will consult with AM staff prior to approval of a release to
9 obtain AM's approve of the release. Multifamily Regional Center/Program Centers
10 should exercise caution to be certain that monthly results are not erratic or seasonal
11 and that 1.0 or better debt service coverage will be sustainable after release of the
12 escrow funds. HUD will approve a request for release of funds on Form HUD-
13 92464M from the lender. The lender's file should contain the HUD approval and
14 documentation supporting the release.

15 **12.16 Insurance Upon Completion**

- 16 A. Basic requirements during construction stage are generally the same as for projects with
17 insured advances. However, because HUD does not insure advances for the construction
18 loan, HUD does not monitor the lender's disbursements. Additionally, because HUD has
19 no risk exposure until final endorsement, HUD does not become involved in the workout
20 of construction problems. The following are major variations from standard program
21 requirements for insurance upon completion projects.
- 22 B. Firm Commitment to Insure upon Completion, Forms FHA-2453, FHA-2453-MM (for
23 Section 223(f)), must be valid and outstanding until Final Endorsement of the permanent
24 mortgage.
- 25 1. No initial closing. The construction stage starts after the issuance of the Firm
26 Commitment.
- 27 2. Construction/rehabilitation must start and be completed within the period provided by
28 the Firm Commitment.
- 29 3. Extensions. See Chapter 11 for the extension of:
- 30 a. Construction period;
- 31 b. Firm Commitment expiration date, where required to permit project completion
32 and Final Endorsement.

- 1 C. Required documents include:
- 2 1. Construction contract, Form HUD-92442M. The following must be made a part of
- 3 the contract:
- 4 a. General Conditions, AIA Document A201;
- 5 b. Supplementary General Conditions, Form HUD-92554M;
- 6 c. Davis-Bacon Wage Rates (supplied by HUD Labor Relations);
- 7 d. HUD Amendment to the B108, Owner-Architect Agreement to Identify Identities
- 8 of Interest Between Owner/Contractor/Subcontractor/Architect;
- 9 e. Cost certification criteria from Form HUD-92442M, Article 13, where an identity
- 10 of interest exists or a “cost plus” form of contract is used.
- 11 2. A complete master set of drawings and specifications and two duplicate sets;
- 12 3. The Agreement and Certification, Form HUD-93305M, executed by the mortgagor,
- 13 lender, and HUD.
- 14 4. A title policy or title evidence showing:
- 15 a. Insured property free of all encumbrances other than the mortgage and acceptable
- 16 reservations of title;
- 17 b. Proof that no unpaid obligations exist except as previously approved by HUD;
- 18 c. Title policy continued to date of credit instrument endorsement.
- 19 5. Survey and Surveyor’s Certificate, Form HUD-92457A-M;
- 20 6. Contractor’s Requisition Project Mortgages, Form HUD-92448. The Contractor’s
- 21 Prevailing Wage Certificate must be submitted at the time the mortgage is presented
- 22 to HUD for insurance.
- 23 7. Assurance of funds to meet operating deficit. Completed Forms to assure funds are
- 24 available to carry the project to a sustaining occupancy after final closing:
- 25 a. HUD-92476M, Agreement of Sponsor to Furnish Additional Funds,
- 26 b. HUD-92476a-M, Escrow Agreement for Operating Deficit, and
- 27 c. HUD-92477M, Bond Guaranteeing Sponsor’s Performance.
- 28 8. Assurance of completion: Not applicable to insurance upon completion projects.
- 29 9. Warrantee against latent defects is required in accordance with Section 12.16.S.
- 30 D. The pre-construction conference must precede the initial start of construction, see Section
- 31 12.2.
- 32 E. Construction monitoring and reporting must be done in accordance with Section 12.3.

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- 1 F. Labor and FHEO liaison, see Section 12.12.
- 2 G. Contractor's monthly requisitions are not applicable to projects insured upon completion.
- 3 H. Offsite construction:
- 4 1. Monitoring is recorded by the HUD inspector on Form HUD-95379.
- 5 2. Advance of funds monitoring is not applicable to projects insured upon completion.
- 6 I. Construction contract changes and Architect's supplemental instructions (see Sections
- 7 12.8 to 12.11 and 12.4.D). Construction changes are processed in the same manner as
- 8 insurance of advances, except as modified below:
- 9 1. An escrow is not required for additive change orders, because HUD has no risk
- 10 exposure until final closing. The mortgagor must be able to provide the additional
- 11 funds required and must not have any outstanding obligation in connection with
- 12 construction other than the insured mortgage at the time the mortgage is presented for
- 13 insurance.
- 14 2. Surety approval is not required for the approval of additive change orders regardless
- 15 of the percentage of contract increase.
- 16 J. Permission to Occupy applies as in Section 12.14.
- 17 K. Final HUD representative's Trip Report falls under HUD procedures.
- 18 L. Guarantee period falls under HUD procedures.
- 19 M. Working capital deposit and operating deficit escrows are not usually required for
- 20 Insurance upon Completion projects. However, to mitigate any risk, projects that apply
- 21 for Insurance upon Completion must fully meet the operating deficit escrow and the
- 22 working capital requirements contained in Section 8.13, except for the extra 2% new
- 23 construction contingency portion of the working capital escrow which is not required.
- 24 See Sections 12.15.C and 12.15.E for releasing escrowed funds.
- 25 N. Property insurance schedule and requirements. When onsite construction is 80%
- 26 complete (before Final Endorsement of the mortgage), the lender must prepare:
- 27 1. Property Insurance Schedule, Form HUD-92329, that:
- 28 a. Correctly shows the insurable value of the completed structures;
- 29 b. Reflects any changes in cost occurring after issuance of firm commitment.
- 30 2. Property Insurance Requirements, Form HUD-92447.

- 1 O. MIP is not charged until the project reaches final closing.
- 2 P. Cost certification (see Chapter 13).
- 3 Q. Closing must occur within the period provided in the commitment.
- 4 R. Extension of Firm Commitment instructions are in Chapter 11.
- 5 S. Builder's warranty. The general contractor must enter into a latent defect agreement with
6 HUD and provide one of the following at Final Endorsement to assure correction of any
7 latent defects:
 - 8 1. Cash escrow deposit of 2.5% of the principal amount of the mortgage, to be retained
9 in escrow by the lender for a period of 15 months, or
 - 10 2. An irrevocable, unconditional letter of credit issued to lender by a banking
11 institution, or.
 - 12 3. Surety bond in the amount of 10% of the cost of construction or substantial
13 rehabilitation. The bond must be in effect for 2 years after substantial project
14 completion. The bond must be on Form HUD-3259, Surety Bond Against Defects
15 Due to Defective Materials and/or Workmanship.
 - 16 4. In cases when the latent defect escrow amount is small because total repair cost is
17 minimal (e.g., less than \$200,000), the escrow is not required. The HUD Regional
18 Center has the discretion to waive the latent defect escrow.

21 **12.17 Completion of Repairs Pursuant to Section 223(f)**

- 22 A. Required Repairs are to be documented by the lender with a list that categorizes repairs
23 as critical repairs or non-critical repairs. (See Chapter 5, Section 5.26 and Appendix 5H).
 - 24 1. Critical repairs must be completed before closing. Critical repairs are any individual
25 or combination of repairs required to correct conditions that:
 - 26 a. Endanger the safety or well-being of residents, visitors or passers-by;
 - 27 b. Endanger the physical security of the property;
 - 28 c. Adversely affect project or unit(s) ingress or egress; or
 - 29 d. Prevent the project from reaching sustaining occupancy.
 - 30 2. Non-critical Repairs consist of all repairs other than Critical Repairs. Non-critical
31 Repairs may, at the request of the mortgagor, be completed after closing.

1 3. Completion of repairs.

2 a. Before closing. Critical repairs must be completed before closing. A site visit(s) and
3 report(s) by a HUD representative is required to confirm satisfactory completion of
4 required repairs before closing unless HUD waives or delegates the responsibility.

5 b. After closing. Only non-critical repairs may be completed after closing. The
6 following schedules are required:

7 (1) Schedule of Values for payment of completed repairs;

8 (2) Progress Schedule. All repairs must be completed within 12 months of loan
9 closing;

10 (3) Schedule of Delayed or Interrupted Occupancy or Income, must list:

11 (a) All facilities for which occupancy or income will be delayed or
12 interrupted by repairs delayed until after closing;

13 (b) Period of delayed or interrupted occupancy or income;

14 (c) Projected completion date.

15 (4) Release of Cash/ Equity from Loan Proceeds. For projects with cash out
16 proceeds and incomplete non-critical repairs, an escrow equal to 50% of the
17 balance of cash out proceeds (after funding transaction costs and the
18 assurance of completion requirement), must be established at Initial/Final
19 Endorsement, on Form HUD-92476.1M, Escrow Agreement for Non-
20 Critical, Deferred Repairs. These funds must be held by the lender until all
21 required non-critical repairs are complete, which must be within 12 months
22 of the initial endorsement. The borrower can request release of these funds
23 after completion of the repairs, subject to evidence that title is free and clear
24 of mechanics liens, and that latent defects assurance is in place and has been
25 submitted to HUD.

26 4. Payment for Repairs.

27 a. Repairs completed before closing: No mortgage proceeds may be advanced.

28 b. Repairs completed after closing:

29 (1) A completion repair escrow account must be established and held by
30 lender in an amount equal to 120% of the estimated repair costs (see Section
31 5.26.D.2).

- 1 (2) The Schedule of Values for completed repairs will be provided to the
2 HUD inspector, who will recommend progress payments from this
3 Schedule as a part of the Trip Report, Form HUD-95379.
- 4 B. Inspection of completed repairs is performed by the HUD inspector.
- 5 1. Inspection Reports are filed on Form HUD-95379, HUD Representative’s Trip
6 Report, for each monitoring visit. The following are included in the Trip Report:
- 7 a. Non-compliance with provisions of the commitment or closing, e.g. work write-up,
8 drawings, specifications, etc., including changes made to the work without prior
9 approval;
- 10 b. Adverse conditions e.g. slow work completion, destruction of work, new
11 municipal requirements, disputes, etc.
- 12 c. Availability for use of facilities listed on the schedule of delayed or interrupted
13 occupancy.
- 14 d. Municipal authorizations. Permissions to occupy use permits, etc. Where
15 applicable, these must be issued before closing, unless related to work delayed
16 until after closing;
- 17 e. Items of delayed completion. The HUD inspector must include:
- 18 (1) A detailed list of any exterior work;
- 19 (2) Recommended escrow amount; and
- 20 (3) Recommended completion date (not later than 12 months after closing);
- 21 2. Assignment documents. The HUD inspector should assemble the following
22 documents to monitor repairs and recommend payments:
- 23 a. Firm Commitment;
- 24 b. Escrow agreement (where closing has occurred);
- 25 c. Survey, surveyor’s report and legal description;
- 26 d. List of required repairs (work write-up);
- 27 e. Drawings and specifications (where required);
- 28 f. Schedule of Values (required only for projects with repairs delayed after closing);
- 29 g. Progress schedule (required only for projects with repairs delayed after closing);
- 30 h. Schedule of delayed or interrupted occupancy or income (required only for
31 projects with repairs delayed after closing); and
- 32 i. Agreement and Certification.

- 1 C. Repair completion. All work must be acceptably completed before the loan closing,
2 except for the following:
- 3 1. Minor exterior work, which cannot be completed because of weather conditions, may
4 be completed after closing, on projects for which prior provisions were not made for
5 completion of non-critical work after closing; include the amount (s) to be escrowed.
 - 6 2. Non-critical repairs may be completed after closing when provided in the
7 commitment and when a completion escrow is established at closing, except that:
 - 8 a. All critical repairs must be completed before closing, and
 - 9 b. An additional deposit must be made to the operating deficit account for delayed
10 repairs which will delay or interrupt occupancy or income for any period. The
11 amount of the additional deposit will be determined by HUD.
 - 12 3. Repair monitoring. All work must be monitored and be acceptable to the lender and
13 HUD whether it is performed before or after closing.
- 14 D. Final report must be made upon completion of all work. The final report must show that:
- 15 1. All work is acceptably completed in accordance with the firm commitment and/or
16 closing escrow, as applicable, and approved changes;
 - 17 2. Offsite work is completed or that the municipality has given written assurance for its
18 completion;
 - 19 3. Utilities are connected;
 - 20 4. Permanent ingress and egress facilities are provided, and
 - 21 5. Applicable municipal inspections, approvals, etc., have been issued.
- 22 E. Changes in the work, including associated cost changes, must be submitted by letter or
23 other acceptable format. Form HUD-92437 may be used as a general guide, but the actual
24 form must not be used.
- 25 1. Borrower, HUD and lender must sign all changes;
 - 26 2. Contractor and borrower's Architect, if employed, must sign all changes.
- 27 F. Guarantee inspections. Where the owner uses a contractor, rather than its own staff, to
28 carry out repairs, guarantee inspections will be scheduled to discover and require
29 correction of latent defects within 1 year of the date of substantial completion of all
30 repairs. See Sections 12.6.C and 12.16.C.
- 31 G. Projects in difficulty. Physical, financial, or management problems could be an indication
32 that a default is imminent. For further explanation see Management Agent Handbook
33 4381.5 REV-2 Chapter 6 Exhibit 6-1.

- 1 1. If the borrower has not completed all deferred repairs by the end of the repair period
2 (including any approved extensions), the HUD Inspector will document all such non-
3 completed repairs on Form HUD-95379, HUD Representative’s Trip Report, and will
4 submit the report to the lender with a copy to the HUD CM.
- 5 2. The lender will complete the repairs using the escrowed funds. The lender will
6 submit a work schedule to HUD for the completion of all remaining repairs, and will
7 provide the borrower with a breakdown of these repairs and the cost(s) of completion
8 (including administrative expenses).
- 9 3. Funds remaining in the repair escrow account after completion of the repair work by
10 lender will be returned to the borrower, less reasonable administrative costs incurred
11 by lender in completing the repairs.

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Chapter 13 Cost Certification

13.1 Projects that Must Certify

Cost certification is required for all insured multifamily projects, except when the mortgage is 80 percent or less of value and at least one of the following two criteria applies: the transaction involves tax credits, or the project is refinancing under Section 207/223(f).

13.2 Purpose of Certification

The purpose of certification is to establish the borrower's actual costs, including contractor's cost, and establish the "maximum insurable mortgage" for Final Endorsement of the insured mortgage.

13.3 Certifiable Costs

Certifiable costs are those costs that have been paid in cash or will be paid in cash within 45 days of final closing, except for:

- A. Land Value which HUD will calculate,
- B. General Overhead which is certifiable whether or not it is paid in cash,
- C. BSPRA, which is cost certifiable whether or not it is paid in cash, where there is an identity of interest between the borrower and contractor, and
- D. Non-profit Developer's Fee, which is cost certifiable whether or not it is paid in cash, less amounts certified to and allowed on other line items.

13.4 Projects with LIHTCs are Exempt from Cost Certification Requirements

The Housing Economic Recovery Act (HERA) of 2008 affected the borrower's obligation to certify "actual cost" (as defined in the National Housing Act) under the mortgage insured

1 programs. If it is determined at the time of issuance of the firm commitment for insurance that
2 the ratio of loan proceeds to the mortgageable (?) actual cost of the project is less than or equal to
3 80 percent, the borrower is not required to certify actual cost to HUD. The exemption affects
4 construction, rehabilitation (including property acquisition), purchase or refinance of a
5 multifamily housing project for which equity is provided through tax credits, i.e. LIHTC,
6 Historic Tax Credits or New Market Tax Credits Because the actual cost is not known at the
7 time of the issuance of the firm commitment, the Total Estimated Replacement Cost of the project
8 (Section G, line 74 on the Form HUD-92264) will be used in lieu of actual cost to determine the
9 exemption from cost certification. . An example of this computation is below.

10 Note that the borrower and the general contractor have the option to cost certify according to the
11 guidance in Sections 13.6 through 13.19.

12 A. This example illustrates the applicability of the cost certification exemption for a new
13 construction and substantial rehabilitation project using the lowest controlling mortgage
14 criteria.

15 Total Project Replacement Cost (Section G line 74 Form HUD-92264) \$ 13,000,000

16 Tax Credit Equity for Mortgageable Items (Form HUD-92264-A)\$ 5,000,000

17 Maximum Insurable Mortgage Amount (Form HUD-92264-A)\$ 8,000,000

18 $\$ 8,000,000 / \$13,000,000 = 62\%$

19 B. Audit Fee

20 In cases that are exempt from cost certification, a Cost Certification Audit Fee, Section G
21 line 66, on Form HUD-92264 is not applicable. The borrower and the general contractor
22 may certify to their actual costs. Should they decide to cost certify per HUD's
23 methodology, the audit cost is mortgageable.

24 C. Substantial Completion Date

25 1. The substantial completion date is the date the Architect dates and signs the
26 certification on Form HUD-92485, Permission to Occupy Project Mortgages (PTO).
27 Upon execution, the Architect certifies that the construction work is sufficiently
28 complete in accordance with the construction contract documents such that the
29 project may be occupied for the intended use except for acceptable items of delayed
30 construction completion. The HUD inspector will complete the portion, "FHA

1 Inspection Report” on the Form to verify that construction is substantially complete
2 and the project is suitable for occupancy. The Form is subsequently signed by
3 HUD’s Authorized Agent granting approval of the PTO. Upon execution of the PTO
4 the HUD inspector must prepare, date and sign the final Form HUD-95379, HUD
5 Representative’s Trip Report documenting the project has reached 100% substantial
6 completion. The-Regional Center or Satellite Office will notify the borrower, general
7 contractor, and lender, in writing of the substantial completion date so that
8 preparation for final closing can begin.
9

- 10 2. The final trip report will mark when project operations begin. In the absence of a
11 cost certification cut-off date, the Production staff will enter “The Date of Visit”
12 from the final HUD-95379 as the cost cut-off date in the HUD data system (e.g.
13 DAP (Development Application Process) and advise the borrower of the date. The
14 day after that date becomes the “Financial Assessment Subsystem (FASS) date” to
15 start project operations and begin annual financial statement (AFS) reporting.

16 D. Operating Income Generated During the Construction Period

- 17 1. The borrower must account for all operating income generated during construction and
18 ending three months before the originally scheduled date of the first principal payment
19 under the mortgage. In cases such as new construction with partial occupancy approval
20 as described in Section 12.14.D or a substantial rehabilitation tax credit project, without
21 significant resident displacement, there may be considerable net operating income (NOI)
22 (or interim income) generated during the construction period. This interim income may
23 be used to pay for mortgageable and non-mortgageable items. Therefore, the borrower
24 must prepare an Operating (or Income and Expense) Statement covering the period from
25 first occupancy (if occupancy occurred during construction see Section 12.14.D) or from
26 the date of substantial completion through the period ending three months before the date
27 of the first principal payment of the originally scheduled mortgage date. The borrower
28 may include in the operating statement all soft costs incurred up to 60 days beyond this
29 date, which will establish the cut-off date. The day after the cut-off date becomes the
30 FASS and operations reporting date. The lender must submit the borrower’s operating
31 statement to HUD at least 30 days before the Final Endorsement scheduled date. If the
32 operating statement evidences receipt of NOI during this period, the borrower is able to
33 apply the income according to the following:

- 1 a. If the replacement cost mortgage (Criterion 3) is not the controlling mortgage, any
2 NOI generated during construction may be applied to cover shortfalls in
3 mortgageable soft costs, change orders, initial operating deficit and escrows. At Final
4 Endorsement the balance of funds may be distributed to the borrower or deposited to
5 the Reserve for Replacement account or applied toward the amortization of the
6 mortgage principal. For Non-Profit borrowers processing under the 221(d)(3)
7 program the balance of income must be deposited into the project's Reserve for
8 Replacement account.
- 9 b. If the replacement cost mortgage (Criterion 3) is controlling, the Mortgage Credit
10 staff will determine if the balance of the net operating income is equal to or greater
11 than 1% of the original mortgage amount and, if it is, will deduct this amount from
12 the certified replacement cost. Balance of the net operating income" (NOI) will be
13 calculated from first occupancy up to 3 months prior to the first scheduled note
14 payment. When the NOI does not meet this 1% threshold, it can be used toward
15 shortfalls as instructed in number 1 above. Any remaining balance must be deposited
16 into the Reserve for Replacement account at Final Endorsement and there is no
17 distribution to the mortgagor. For Non-Profit borrowers processing under the
18 221(d)(3) program, the balance of income must be deposited into the Reserve for
19 Replacement account.
- 20 c. See Section 13.19.C below on the distribution prohibition for a borrower's affiliate or
21 principal.
- 22 2. In those cases whereby interim income is not generated or the borrower opts not to set a
23 cost cut-off date, it is not necessary for a borrower to submit an operating statement. The
24 Regional Center or Satellite Office will notify the lender, borrower, and general
25 contractor, in writing, of the 100% substantial completion date from the final Form HUD-
26 95379, HUD Representative's Trip Report. The Production staff will entered "The Date
27 of Visit" from the final HUD-95379 as the cost cut-off date, into the HUD data system.
28 The day after this date will be considered the start of project operations and FASS
29 reporting.
- 30 E. Copy of Final Sources and Uses Statement. The lender may submit a copy of the final
31 Sources and Uses Statement prepared by the state tax credit allocating agency to assist in the
32 lender and HUD review of the final amounts of sources, income and uses.
- 33 F. Modification to Form HUD-92580 – Determination of Maximum Insurable Mortgage

1 For those projects that are exempt from providing a cost certification, after substantial
 2 completion, the Hub or PC will issue a modified Form HUD-92580, as illustrated below.
 3 Strikeouts are illustrated on line items 2 and 10, below:

4 1. (a) Original Mortgage Amount \$10,000,000.00

5 (b thru e) are not applicable - *Insert N/A or cross through.*

6 2. ~~Certified Actual Cost~~ – *Strike certified actual cost and Insert*

7 *Replacement Cost From Section G Line 74*\$13,000,000

8 3. Disallowed Cost(*Insert N/A*).....\$ N/A

9 4. Recognized Actual Cost of Improvements ... (Sec. G Line 74)\$13,000,000

10 5. Land\$

11 6. TOTAL LAND AND IMPROVEMENTS\$13,000,000

12 7. Statutory Percentage of Total Cost (____ % of item 6)\$ N/A

13 8. For Substantial Rehabilitation-Property Owned, enter the Lesser of:

14 (i) \$ _____ existing Mortgage Indebtedness on (Land and Improvements
 15 to be Rehabilitated) or (ii) An Amount Equal To ____% of the Fair
 16 Market Value \$ _____ of Land and Improvements

17 Before (Repair or Rehabilitation)

18\$ N/A

19 9. TOTAL Line 7 plus line 8, (if any)\$ N/A

20 10. Maximum Insurable Mortgage in Multiples of \$100, (Item 1(a)) or

21 Item 6 whichever is the Lesser) (~~Item 1(e) or Item 9 whichever is~~

22 ~~the Lesser~~) if Grants involved see attached Sheet to this form for

23 ~~Reconciliation of Adjustment, if required~~\$10,000,000

1 **NOTE:** The Mortgage Credit staff should note on this Form that the project is exempt from
2 cost certification due to the *loan proceeds* to actual cost being less than 80%. Insert
3 the actual percentage of the loan to cost _____.

4 Completion of the reverse side of the Form as follows:

5 Schedule 1 N/A

6 Schedule 2 Disallowed Costs: N/A

7 Schedule 3 Computation of Borrower's Initial Equity Investment

8	1. Total Land and Improvements (line 6 above)	<u>\$13,000,000</u>
9	2. Less: Maximum Insurable Mortgage (line 10 above)	<u>\$10,000,000</u>
10	3. Borrower's Initial Equity Investment	<u>\$ 3,000,000</u>

11 **13.5 Types of Cost Certification**

12 A. Standard or "Long Form" Certification is required, except for projects permitted to use
13 the "simplified" cost certification and for certification of projects insured under Section 207.

14 B. Simplified Certification is restricted to projects involving 40 units or less of proposed
15 construction or substantial rehabilitation and is used for projects under Section 207/223(f).

16 C. Section 223(f) Certification is required for all projects insured under Section 207 except
17 the certification is not required for Section 207/223(f) transactions where the insured mortgage is
18 80% or less of the value.

19 D. Section 223(f) Supplemental Certification is required for projects identified in paragraph
20 C above, where completion of repairs is permitted after closing

21 **13.6 Entities That Must Cost Certify**

22 A. The borrower must certify under all programs, except where HUD has determined at the
23 time of issuance of the firm commitment that the insured mortgage under: a) Section
24 221(d)/220/231 new construction/substantial rehabilitation is 80% or less of replacement
25 cost, or b) Section 207/223(f) refinance is 80% or less of value, **and** the projects are
26 assisted with LIHTC, Historic Tax Credits or New Market Tax Credits.

- 1 B. When the borrower is required to cost certify, the Contractor must also cost certify when:
- 2 1. The Contractor has an identity of interest with the mortgagor, whether such identity
- 3 of interest existed or developed before or after the initial closing (for insured
- 4 advances projects) or issuance of the Firm Commitment (for insurance upon
- 5 completion projects); and/or
- 6 2. The Contractor used the Construction Contract-Cost Plus, Form HUD-92442M,
- 7 whether or not any identity of interest with the borrower existed or developed.
- 8 C. When the Borrower is required to cost certify the subcontractors at any tier, equipment
- 9 lessors, material suppliers and manufacturers of industrialized housing must cost certify
- 10 where:
- 11 1. The total of all subcontracts, purchases, and leases are more than 0.5% of the mortgage, and
- 12 2. An identity of interest exists or comes into being between such subcontractor,
- 13 equipment lessor, material supplier, or manufacturer of industrialized housing and
- 14 either:
- 15 a. The borrower, or
- 16 b. The contractor where the contractor must cost certify.

17 **13.7 Cost Certification Sequence of Events**

- 18 A. Notification of Pre-Cost Certification Conference. HUD must notify the mortgagee,
- 19 borrower, and contractor when the project is 80% complete. HUD should notify new sponsors
- 20 and general contractors as early as 70% completion. The letter should state that:
- 21 1. The borrower, general contractor, their accountants, and the mortgagee should attend
- 22 the conference.
- 23 2. Enclose with the letter the (800) 767-7468 number or the internet address for:

- 1 a. Handbook IG 2000.4 Consolidated Audit Guide for HUD Programs:
2 <http://www.hud.gov/offices/adm/hudclips/handbooks/oigh/>.
- 3 b. Four copies of each of the applicable forms (www.hud.gov):
 - 4 (1) Form HUD-92330, Borrower's Certificate of Actual Cost.
 - 5 (2) Form HUD-92330A, Contractor's Certificate of Actual Cost, if applicable.
- 6 B. Conduct of conference is the responsibility of the assigned HUD staff and should be
7 held before the project is 90% complete. At the conference, HUD staff will explain:
 - 8 1. Substantial completion, administrative completion, and cut off dates.
 - 9 2. Documentation required for cost certification including the income statement and balance
10 sheet.
 - 11 3. Remind the borrower and accountant that they are responsible for computing the
12 liquidated damages/actual damages and incentive portions, if applicable, of the
13 construction contract using the certified amounts on Form HUD-92330.
 - 14 4. Necessity for a careful review and completeness of the documentation including
15 dates and signatures, and timeliness of the submission, HUD review, and final
16 endorsement.
 - 17 5. Any problems with prevailing wage certifications or other labor issues.
- 18 C. Cut-off date established for computation of the cost certification. Submission and HUD
19 approval of the cost certification must occur before final closing, except that the Section 223(f)
20 supplemental cost certification is not required until completion of non-critical repairs deferred
21 until after closing.
- 22 D. Upon completion of the project, Form HUD-92464M, Request for Approval of Advance
23 of Escrow Funds, should be prepared by the lender and submitted to HUD for approval.

24 **13.8 Substantial Completion Date, Cut-Off Date, and Final** 25 **Completion Date**

- 26 A. Completion dates.
 - 27 1. The substantial completion date for determining actual costs is the date the Architect
28 dates and signs the certification on Form HUD-92485, Permission to Occupy Project
29 Mortgages. The Architect is certifying that part of or all of the construction work is

- 1 sufficiently complete in accordance with the construction contract documents and that
2 the project may be occupied for the intended use. The form is subsequently signed by
3 HUD's Authorized Agent. Construction must be complete except for acceptable
4 items of delayed completion and the Regional Center or Satellite Office will notify
5 the borrower, general contractor, and mortgagee, in writing, of the substantial
6 completion date.
- 7 2. The substantial completion date is the effective date for cost certification. The borrower
8 has the option to include in the cost certification all soft costs incurred up to 60 days
9 beyond this date. The date selected by the borrower is the "cut-off date" for the soft
10 costs.
- 11 3. The borrower's balance sheet and operating statement date must agree with the
12 selected cut-off date.
- 13 4. The final completion is the date the HUD Inspector signs the final HUD
14 Representative's Trip Report, Form HUD-95379, provided that the Construction
15 Manager subsequently endorses the trip report. Construction must be 100%
16 complete.
- 17 5. For financial reporting purposes, the day after the cut-off date is the commencement
18 of operations and the projects' first year of reporting annual audited financial
19 statements. This first year will cover the period from the day after the cut-off date to
20 the projects' fiscal year end. This is the date Asset Management will start
21 monitoring the project's financial condition (monthly accounting reports) once the
22 certificates of occupancy (Form HUD-92485) are issued.

23 **13.9 Administrative Completion Date**

24 The Hub Director may advance the completion date to prevent unnecessary accumulation of soft
25 costs when projects which are nearly complete face unnecessary delay.

26 A. The Hub Director may set an administrative completion date for any project when the
27 monthly inspection reports show 95% completion of work and thereafter less than 2% increase in
28 percentage of completion in any month.

29 B. The Hub Director will notify the borrower, general contractor, and mortgagee in writing
30 of the administrative completion date and the following:

- 31 1. The administrative completion date is the effective date for cost certification
32 except that all soft costs up to 60 days beyond this date may be included at the
33 option of the borrower.

- 1 2. The date of the balance sheet and operating statement must be the same as the cut-off
- 2 date selected by the borrower.
- 3 3. Liquidated/actual damages for cost certification purposes will be computed using the
- 4 administrative completion date. However, the general contractor is responsible for
- 5 liquidated/actual damages through the date of substantial completion.
- 6 C. Copies of the notification go to the HQ Docket, Office Docket, and Closing Attorney's
- 7 file.

8

9 **13.10 Submission Date**

10 The submission date for cost certification should be within 30 to 45 days after the cut-off

11 date, and not less than 30 days before the desired final closing date.

12 **13.11 Required Forms**

13 A. Form HUD-92330, Borrower's Certificate of Actual Cost; see line-by-line instructions

14 contained in the Forms Book or on the multifamily internet site:

15 <http://www.hud.gov/offices/adm/hudclips/index.cfm>.

16 B. Form HUD-92330A, Contractor's Certificate of Actual Cost; see instructions contained

17 herein at Sections 13.12, 13.16, and 13.17. The subcontractor, material supplier, industrialized

18 housing manufacturer, and the equipment lessor are required to use this form to certify cost.

19 Note: When a project includes rehabilitation and new construction, a separate form is

20 required for each, with a master form summarizing total project costs, including fees.

21 C. Form HUD-2205-A, Borrower's Certificate of Actual Cost (Section 207 Pursuant to

22 Section 223(f)), and line by line instructions are contained in the Forms Book or on the

23 multifamily internet site <http://www.hud.gov/offices/adm/hudclips/index.cfm>.

24 **13.12 Required Statements and Certifications**

25 For all projects, regardless of whether the project has a cost certification exemption, the required

26 statements and certifications are:

1 C. New construction - an unaudited balance sheet that covers the period from the date of
2 initial endorsement through cut-off and an unaudited income statement that covers the
3 period from the date of initial occupancy through the cut-off date. The format and content
4 of the balance sheet must follow Section 13.12.B.4 & B.5, below.

5 D. Substantial rehabilitation – an unaudited balance sheet and an unaudited income
6 statement that is dated from the date of initial endorsement through the cut-off date. The
7 format and content of the balance sheet must follow Section 13.12.B.4 & B.5, below.

8 Follow either A or B, below, depending on qualifications in A.1.

9 A. Simplified Form of Cost Certification. Use Forms HUD-92330, HUD-92330A (if a cost
10 plus construction contract was used or an identity of interest exists between the borrower and the
11 general contractor). An accountant's opinion is not needed.

12 1. Simplified cost certification is permitted for new construction or substantial
13 rehabilitation projects involving 40 units or less and for refinancing or purchase of
14 existing properties under 207/223(f).

15 2. If there is an identity of interest between a subcontractor, material supplier,
16 equipment lessor, or manufacturer of industrialized housing and the borrower and/or
17 general contractor must cost certify, and the total of all identity of interest
18 subcontracts, purchases and leases is more than 0.5% of the mortgage, the identified
19 party uses Form HUD-92330A. This requirement established by the Agreement and
20 Certification, Form HUD-93305M, applies in all cases.

21 3. An un-audited balance sheet of the borrower entity, as of the cut-off date is required in all
22 cases. Format and content of the balance sheet must follow Section 13.12.B.4, below.

23 4. An un-audited operating statement is required if occupancy occurred during construction.
24 Format and content of the operating statement must follow Section 13.12.B.5, below.

25 B. Long Form Cost Certification. For cases that do not qualify for simplified cost
26 certification based upon paragraph A.1, above, please submit the following:

27 1. Borrower's Certificate of Actual Cost, Form HUD-92330, supported by an
28 accountant's opinion (refer to Section 13.12.B.6).

29 2. Contractor's Certificate of Actual Cost, Form HUD-92330A, supported by an
30 accountant's opinion (refer to Section 13.12.B.6), is required if there is an identity of
31 interest with the borrower or if a cost plus construction contract was used.

32 3. Subcontractors, suppliers, and equipment lessor with an identity of interest with either
33 the borrower or general contractor must submit Form HUD-92330A supported by an
34 accountant's opinion.

- 1 a. Material suppliers. Attach to Form HUD-92330A a sheet showing:
- 2 (1) Quantities furnished.
- 3 (2) Sources from which the materials were obtained.
- 4 (3) Unit prices paid to the sources, brand names, model numbers, sizes,
5 lumber grades, etc., as applicable.
- 6 NOTE: No amount will be included for general requirements (i.e.: job overhead).

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- 1 b. Equipment Lessor. Attach to Form HUD-92330A a sheet showing:
- 2 (1) Dates the equipment was acquired,
- 3 (2) Age of equipment at acquisition date,
- 4 (3) Brand names and model numbers,
- 5 (4) Sizes,
- 6 (5) Dates and length of time used, and
- 7 (6) Rates charged.
- 8 (a) The Lessor(s) must certify that:
- 9 (i) The rates charged were not more than the local going rate
- 10 obtainable in the area, including any maintenance and
- 11 repair.
- 12 (ii) The time charged was not more than essential for the
- 13 project.
- 14 (iii) The charges did not exceed the purchase price of the
- 15 equipment.
- 16 (b) Lump Sum Basis. Instead of providing an attachment containing
- 17 the above information, the lessor(s) may elect to certify to charges
- 18 at 85% of the local going rates for identical equipment under arms'
- 19 length (lump sum) leases. When using this alternative, the lessor
- 20 agrees:
- 21 (i) The Hub is the sole judge of the reasonableness of the time
- 22 and rates charged, and
- 23 (ii) Equipment maintenance and repair expense is the
- 24 responsibility of the lessor(s) and is not included as an
- 25 additional cost.

- 1 (c) Subcontractor's equipment. Costs for subcontractor(s) equipment,
2 whether owned or rented, are considered in the markup for overhead
3 and profit. These costs shall be reflected in the total subcontract and
4 in the prior approval of identity of interest entities. A separate
5 certification of the equipment is not required.
- 6 (d) Manufacturer of Industrialized Housing. Attach to Form HUD-
7 92330A, a breakdown of Division 13, Special Construction
8 showing:
- 9 (i) Manufacturing costs.
- 10 (a) Labor
- 11 (b) Materials
- 12 (c) Sales and any other taxes
- 13 (d) Factory overhead
- 14 (e) General overhead and profit

15 **NOTE:** The manufacturer's accounting system must follow generally
16 accepted accounting procedures, which will allow certification of the
17 actual cost of manufacturing by a Certified Public Accountant or
18 Independent Public Accountant. No amount will be included for
19 transportation or work at the project site.

1 (ii) Transportation costs, factory to project site (if provided by
2 manufacturer).

3 (a) Labor

4 (b) Equipment

5 (iii) On-site erection costs (if provided by manufacturer).

6 (a) Labor

7 (b) Equipment

8 (c) Materials

9 (d) General requirements (job overhead)

10 (iv) The remainder of the manufacturer's Form HUD-92330A is
11 completed per outstanding instructions.

12 NOTE: There can be no duplication of manufacturing costs, i.e., repair of
13 components damaged in shipment.

14 4. An audited balance sheet of the borrower entity, as of the cut-off date is required.

15 a. The balance sheet must contain the following certification:

16 I HEREBY CERTIFY that the foregoing figures and statements contained herein
17 submitted by me as agent of the borrower [owner] for the purpose of obtaining
18 mortgage insurance under the National Housing Act are true and give a correct
19 showing of (Name of borrower or owner) financial position as of (date of
20 financial statement).

21 Signed this ___ day of _____, 20XX_____ (Signature of
22 authorized agent with name printed or typed under signature)

23 WARNING: HUD will prosecute false claims and statements. Conviction may
24 result in criminal and/or civil penalties. (18U.S.C. 1001, 1010, 1012; 31U.S.C.
25 3729, 3802)

- 1 b. Furnish reconciling information if short-term liabilities on the balance sheet do
2 not agree with Column B of Form HUD-92330.
- 3 c. Explain the purpose of all liabilities in the notes to the financial statement and
4 include repayment requirements of the liabilities. Take special care to note any
5 liabilities included for repayment on the balance sheet that were not disclosed
6 during the firm processing stage or before initial endorsement. If such liabilities
7 are found, inform the borrower that the liabilities cannot be an obligation of the
8 project; repayment is the responsibility of the borrower. These liabilities will not
9 be considered (allowed nor disallowed) in the review of the cost certification.
10 When non-disclosures are found it requires a detailed review of cost certification
11 Forms HUD-92330 and HUD-92330A.
- 12 d. If proceeds and obligations from project syndication are passed through the books
13 and records of the borrower entity, reflect receivables as an asset of the borrower
14 entity.
- 15 e. The notes to the balance sheet must identify the original amount of and
16 summarize the expenditures from the working capital deposit.
- 17 5. An audited operating statement is required if occupancy occurs before the cost
18 certification cut-off date.

- 1 a. The statement must contain the certification contained in Section 13.12.B.4.
- 2 b. Prepare the operating statement on an accrual basis.
- 3 c. The statement covers the beginning of marketing and rent-up activities (or date of
4 initial endorsement in rehabilitation projects where occupancy is continuous) to
5 the cut-off date.
- 6 d. Marketing and rent-up activities will start no later than 6 months before the
7 issuance of the first Permission to Occupy-Project Mortgages, Form HUD-92485.
- 8 e. The statement must show the actual dates covered rather than language such as
9 "From the Date of Commencement of Marketing and Rent-up Activities, etc."
- 10 f. The statement must show income from all sources. Do not consider security deposits as
11 income.
- 12 g. The operating statement should not contain any expense items that were paid or
13 should have been paid from the working capital deposit or otherwise included in cost
14 certification.
- 15 h. Operating expenses may include:
 - 16 (1) Expenses directly relating to renting the project, such as:
 - 17 (a) Rental commissions customary for the type of project, if any, and
 - 18 (b) Marketing and advertising expenses.
 - 19 (2) Purchase of furnishings, equipment not paid from the working capital deposit,
20 and supplies essential to project operation.
 - 21 (3) Reasonable fees for preparing any Federal, State, or local tax return
22 information required of the project.
 - 23 (a) For example: If the borrower entity is a partnership, the cost of preparing
24 both Form 1065, U.S. Partnership Return of Income, and related K
25 Schedules may be considered. Do not recognize the cost of preparing a
26 partner's personal Form 1040 return.

- 1 (b) For projects owned by an individual include the cost for preparing any tax
2 return schedule related to project operations; but do not other parts of the
3 owner's return.
- 4 (4) Electricity, gas, water, and operating salaries (maintenance, cleaners,
5 gardeners, elevator operators, etc.) to the extent they are not included in
6 construction cost of Form HUD-92330, Borrower's Certificate of Actual Cost,
7 or HUD-92330A, Contractor's Certificate of Actual Cost.
- 8 (5) Management fee stated in the contract.
- 9 (6) Services not covered by the management fee under Chapter 3 of Handbook
10 4381.5, Compensations for Management Services in Multifamily Housing
11 Projects with Insured or HUD-Held Mortgages.
- 12 i. Operating expenses may not include:
- 13 (1) Depreciation
- 14 (2) Interest, taxes, property insurance premiums, and mortgage insurance
15 premiums that are reflected in Form HUD-92330, Borrower's Certificate of
16 Actual Cost.
- 17 (3) Salaries paid to principals of the sponsor or borrower for managing the
18 borrower entity.
- 19 j. Treatment of net operating income generated during construction:
- 20 (1) If the replacement cost mortgage (Criterion 3) is not the controlling
21 mortgage, any NOI generated during construction may be applied to cover
22 shortfalls in mortgageable soft costs, change orders, initial operating deficit
23 and escrows. At Final Endorsement the balance of funds may be distributed
24 to the borrower or deposited to the project's Reserve for Replacement
25 account or applied toward the amortization of the mortgage principal.

- 1 (2) If the replacement cost mortgage (Criterion 3) is controlling the Mortgage
2 Credit staff will do a calculation and determine if the balance of the net
3 operating income is equal to or greater than 1% of the original mortgage
4 amount, and if it is, will deduct this amount from the certified replacement
5 cost. When the NOI does not meet this 1% threshold, it can be used toward
6 shortfalls as instructed in number 1 above. Any remaining balance must be
7 deposited into the project's Reserve for Replacement account at final
8 endorsement. There is no distribution to the borrower.
- 9 (3) For a nonprofit mortgagor processing under the 221(d)(3) program:
 - 10 (a) As a recovery of construction costs at cost certification, to the extent
11 that it was used to reduce liquidated/actual damages.
 - 12 (b) As an offset for a mortgage increase.
 - 13 (c) Deposit the unused portion of net income into the project's Reserve for
14 Replacement account at final endorsement.
- 15 k. If operating expenses exceed income:
 - 16 (1) No entry is made on Form HUD-92330, Borrower's Certification of Actual
17 Cost.
 - 18 (2) Operating deficit may be carried over as a reduction to net income on the
19 supplemental operating statement.
- 20 6. A Certification by an independent Certified Public Accountant or an Independent
21 Public Accountant must accompany Form HUD-92330, Borrower's Certificate of
22 Actual Cost, including the audited balance sheet and operating statement of the
23 borrower, and Form HUD-92330A, Contractor's Certificate of Actual Cost.

- 1 a. The accountant must meet the auditor qualifications of the Government Auditing
2 Standards (GAO Yellow Book), including the qualifications relating to
3 independence and continuing professional education. The audit organization also
4 must meet the quality control standards of the GAO Yellow Book.
- 5 b. Part 24 of Title 24 of the Code of Federal Regulations prohibits accountants from
6 contracting for services when their name is shown on the HUD and General
7 Services Administration Government-wide Consolidated List of Debarred,
8 Suspended and Ineligible Contractors and Grantees.
- 9 c. The accountant must also comply with the requirements in Chapters 1, 2, and 6 of
10 HUD Handbook IG 2000.4, "Consolidated Audit Guide for Audits of HUD
11 Programs."
- 12 7. The borrower must submit a supplemental operating income statement if more than 3
13 months exist between the cut-off date and the start of amortization. If a deferment of
14 amortization was granted, (Section 13.26) use the new date for the start of
15 amortization in determining the need for a supplemental operating statement.

- 1 a. This requirement does not apply to nonprofit borrowers or any project where the
2 mortgage is \$200,000 or less.
- 3 b. The statement covers the period from the cost certification cut-off date to the date,
4 which is 3 months before the start of amortization. The borrower should submit
5 the statement within 30 days after the expiration of this period.
- 6 c. If the required original cost certification was audited, a CPA or IPA must prepare
7 and certify the supplemental statement.
- 8 d. The borrower may advance the date of amortization to avoid submitting a
9 supplemental income statement.
- 10 e. In preparing the statement, if the operating statement submitted at cost
11 certification shows expenses in excess of income, such expenses may be carried
12 forward as "un-recovered expense—prior period."
- 13 C. Section 223(f) Projects. The borrower must certify to the total costs incurred in the
14 acquisition or refinancing of the property using Form HUD-2205-A, Borrower's
15 Certificate of Actual Cost. The certification must be dated and signed by an
16 authorized agent of the borrower. An accountant's opinion is not needed.
 - 17 1. The certification must be submitted after all critical repairs have been completed,
18 but at least 15 days before the desired closing date.
 - 19 2. The general contractor will be required to cost certify using Form HUD-92330A
20 if a cost plus construction contract is used.
 - 21 3. A balance sheet and income statement are not required.
 - 22 4. No cost certification is required for a 207/223(f) refinancing transaction where the
23 mortgage is equal to or less than 80% of value.
 - 24 5. For cases involving deferred repairs, the borrower must submit a supplemental
25 cost certification (Form HUD-2205-A) detailing the actual cost of the deferred
26 repairs.

27 **13.13 Deficiencies in Cost Certification Submission**

28

29

When the cost certification package is received for processing:

- 1 A. The Cost and Mortgage Credit reviewers will:
 - 2 1. Determine deficiencies associated with the borrowers' and contractor's cost
 - 3 certifications.
 - 4 2. Advise the Hub Director and estimate the time needed to resolve the problem(s).
 - 5 3. Attempt to resolve all problems by telephone before making a formal written request.
 - 6 This usually allows processing to continue while waiting for a formal reply.
 - 7 4. Send a letter within 5 workdays to the borrower with copies to the general contractor (if
 - 8 applicable), their accountants, and the mortgagee stating the deficiencies and requesting
 - 9 information.
- 10 B. Upon receipt of all necessary information, combined processing should not exceed 15
- 11 workdays.
- 12 C. If the borrower or contractor indicates clarification will be forwarded within 5 work days,
- 13 the conclusions of cost certification can await the additional information.
- 14 D. If not, issue Form HUD-92580.

15 **13.14 Mortgage Credit Limited Review**

- 16 A. In cases where the borrower has not requested a mortgage increase, the HUD staff will:
 - 17 1. Review Form HUD-92330, Borrower's Certificate of Actual Cost. Adjust for items
 - 18 paid out of working capital and costs reflected on income statement.
 - 19 2. Review the reporting of:
 - 20 a. Net income earned before the start of amortization. Report all income earned from the
 - 21 beginning of marketing and rent-up activities to the cut-off date for new construction projects
 - 22 and unoccupied substantial rehabilitation projects. For substantial rehabilitation projects where
 - 23 occupancy is continuous, report all income from the date of initial endorsement or, for insurance
 - 24 upon completion cases, the start of construction to the cut-off date. Make adjustments for
 - 25 ineligible reported expenses, such as depreciation.
 - 26 b. The reporting of all grants/loans received for replacement cost items.
 - 27 3. Complete Form HUD-92580, Maximum Insurable Mortgage, using the figures from
 - 28 Column C, Total, of Form HUD-92330. Complete the forms based on the most
 - 29 current instructions, except for the following changes:

- 1 a. Line 2. Reflect the amount indicated in Column C of Form HUD-92330.
- 2 b. Line 3. Explain any adjustments made to the net income or grant/loan amounts reported
3 on Form HUD-92330.
4 NOTE: If adjustments are made to items other than net income and grants/loans,
5 Form HUD-92331A should be completed.
- 6 4. When the borrower and the contractor submit their individual certificates of actual
7 costs for review they should have already agreed to the amount due the contractor.
8 The amount due the contractor is reported on the certificates of actual costs and there
9 should no disagreement because all “to be paid items” will be listed on the HUD-
10 92580 schedule 1, item by item. The Form HUD-92023, Request for Final
11 Endorsement of Credit Instrument, must match the Maximum Insurable Mortgage,
12 HUD-92580 minus whatever was paid in the interim. As mortgage credit performs
13 the cost certification and prepares the HUD-92580, consider the follow when
14 reconciling the certified costs:
 - 15 a. After completion of the 92580 the Regional Center or Satellite Office notifies the
16 lender/owner/GC of the balance in the line item for the G.C., if there are issues
17 then the Field will not move forward with the cost certification until all pending
18 “to be paid items” are resolved.
 - 19 b. The GC’s cost certification has to balance with the items remaining to be paid.
 - 20 c. Mortgage Credit has to reconcile these numbers at cost certification, if there is a
21 dispute all releases freeze until HUD/lender/GC come to agreement on who is
22 owed what.
- 23 5. Report anything suspicious in the submission, (i.e. liabilities not disclosed during firm
24 processing or before initial endorsement) to the Hub Director, who has the authority
25 to request that a full cost certification review be completed. For such cases, complete
26 Forms HUD-92331-A, and HUD-92580 based on the instructions in the Forms Book
27 or on the multifamily internet site
28 <http://www.hud.gov/offices/adm/hudclips/index.cfm>, and Section 13.16, below.
29 Also, if an accountant’s work is consistently deficient, warn the accountant that
30 borrowers using their services will be advised that HUD will perform a detailed cost
31 certification review.

1 **13.15** **Mortgage Credit Detailed Review**

2 When a mortgage increase is requested of the Hub Director, a more detailed review is
3 required. The HUD Mortgage Credit staff will:

4 A. Carefully review Forms HUD-92330 and HUD-92330-A if required for mathematical
5 accuracy and compliance with prescribed procedures.

6 B. Ensure that the submission contains required schedules and bills, which have not been
7 submitted with previous draw requests, to support the certified amounts for interest, taxes,
8 property insurance, MIP, title and recording, financing fees, legal, organizational and audit
9 fees, offsite costs and other fees.

10 C. Require clarification or breakdown of all, or any part of, the cost figures presented by the
11 borrower or general contractor, if applicable.

12 D. Scrutinize any existence of an identity of interest subcontractor, material supplier or
13 equipment lessor relationship.

14 E. Review the notes and schedules attached to the accountant's opinion. Pay special
15 attention to any liabilities included for repayment on the balance sheet that were not
16 disclosed during the firm processing stage or before initial endorsement. These liabilities are
17 not eligible for inclusion in the cost certification.

18 F. Recommend that the Hub Director request an audit of the borrower's and/or contractor's
19 books by the Regional Inspector General for Audit before issuing Form HUD-92580, Maximum
20 Insurable Mortgage, when differences of opinion arise from other than:

- 21 1. Honest differences of opinion clearly identifiable as such.
22 2. Other justifiable causes.

23 G. If considerable time has passed between initial occupancy and the cut-off date, some items
24 properly allocable to renting and operating the project may be charged against construction cost.

- 25 1. It may not be possible or practical to make precise allocation of such items as gas and
26 electricity, clean-up costs, etc., between construction and operation periods.
27 2. Insist on reasonable allocations and eliminate duplicate claims for the expenses under
28 both categories.

- 1 H. Advise cost staff of any construction costs included in “Miscellaneous” and “Other”
2 categories of Form HUD-92330.
- 3 I. Check items and amounts in the borrower’s cost certification without auditing the
4 borrower’s books and records. An audit may be needed later. (Refer to Section 13.27)
- 5 J. Record the results of the review (including NOI) on Form HUD-92331A, Cost Certification
6 Review Worksheet.

7 **13.16 Allowable Costs in Borrower’s Certificate of Actual Cost**

- 8 A. Construction Contract:
- 9 1. A lump sum construction contract is permitted when no identity of interest exists
10 between the borrower and general contractor. The amount allowed in cost
11 certification is the lesser of:
- 12 a. Actual cash paid or to be paid by the borrower under the construction contract.
- 13 b. Contract price as adjusted by HUD’s estimated cumulative effect of approved change
14 orders paid, or to be paid, by the borrower and the liquidated/actual damages provision to the
15 contract, if applicable.
- 16 2. A cost-plus construction contract is required when an identity of interest exists
17 between the borrower and general contractor.
- 18 3. The amount allowed in cost certification when a cost-plus contract is used is the
19 lesser of:
- 20 a. Actual cash paid, or to be paid, by the borrower under the construction contract.
- 21 b. Amount the cost analyst allowed for construction on Form HUD-92331, Summary of
22 Cost Certification Review–Cost Section.
- 23 c. Contract price as adjusted by the HUD estimated cumulative effect of approved change
24 orders paid, or to be paid, by the borrower and, if applicable, either the incentive provision or the
25 liquidated/actual damages provision of the contract.

26 NOTE:

- 1 (1) Recognize approved change orders necessitated by errors or omissions by
2 the architect only to the extent there are savings in the mortgage. Do not
3 recognize these change orders when processing a mortgage increase.
- 4 (2) Do not recognize approved betterment change orders in calculating the
5 adjusted upset price in paragraphs A.1.b and A.3.c, above, unless they are
6 determined by the cost staff to be necessary changes as defined in Section
7 12.8.
- 8 (3) Recognize the increase in general requirements, if any, noted on approved
9 time extension change orders. Do not recognize increases in soft costs
10 associated with the change order. The soft costs will be recognized under the
11 applicable line items.
- 12 (4) When BSPRA is not applicable, for profit motivated projects involving an
13 identity of interest between the borrower and general contractor, the
14 amount of builder's profit as shown on Form HUD-93305M is eligible
15 whether or not it was paid in cash.
- 16 (5) For nonprofit borrowers, the allowable builder's profit is the lesser of the
17 amount actually paid or to be paid in cash to the general contractor or the
18 amount of builder's profit shown in Section G of Form HUD-92264, plus
19 or minus any amount applicable due to HUD-approved change orders.
- 20 4. An identity of interest is construed to exist when:
 - 21 a. There is any financial interest of the borrower in the general contractor or any
22 financial interest of the general contractor in the borrower.
 - 23 b. Any officer, director, or stockholder or partner of the borrower is also an officer,
24 director or stockholder or partner of the general contractor.
 - 25 c. Any officer, director, stockholder, or partner of the borrower has any financial
26 interest in the general contractor; or any Officer, director, stockholder, or partner
27 of the general contractor has any financial interest in the borrower.
 - 28 d. The general contractor advances any funds to the borrower.

- 1 e. The general contractor supplies and pays, on behalf of the borrower, the cost of
2 any architectural services or engineering services other than those of a surveyor,
3 general superintendent, or engineer employed by a general contractor in
4 connection with its obligations under the construction contract.
- 5 f. The general contractor takes stock or any interest in the borrower corporation as
6 consideration of payment.
- 7 g. There exists or comes into being any side deals, agreements, contracts, or
8 undertakings entered into or contemplated, thereby altering, amending, or
9 canceling any of the required closing documents, except as approved by the
10 Secretary.
- 11 h. Any relationship (e.g. family) existing which would give the borrower or general
12 contractor control or influence over the price of the contract or the price paid to
13 the subcontractor, material supplier or lessor of equipment.
- 14 5. Incentive Fee Payments to Contractors.
- 15 The owner may request that the construction contract be modified before Initial
16 Endorsement to provide for a general contractor incentive fee for completed
17 construction work and delivering a completed project before the date specified in the
18 construction contract (or as amended by HUD-approved time extension(s)). Incentive
19 fees must be specified in an Addendum to the construction contract that has been
20 approved by HUD before initial endorsement or at the execution of a construction
21 contract that has been approved by HUD for Insurance Upon Completion and
22 Insurance of Advance projects. An Incentive Payment Addendum may not be added
23 to the contract after Initial Endorsement.
- 24 a. Identity of interest borrower and general contractor.
- 25 (1) General contractor may benefit from savings in construction interest, taxes,
26 property insurance, and mortgage insurance premiums to the extent there are
27 construction cost overruns.
- 28 (2) Incentive payment is included in the adjusted upset price of the construction contract.

1 If there is an identity of interest between the borrower and the general contractor,
2 an incentive fee may only be paid if there are certified cost overruns that were not
3 included in a HUD approved change order, and the amount of the incentive fee
4 may not exceed the amount of certified cost overruns that were incurred

5 b. Nonidentity of interest borrower and general contractor.

6 (1) Use Construction Contract Incentive Payment, Form HUD-92443.

7 (2) Include the incentive payment under “Other” on Form HUD-92331A.

8 Incentive fees must be calculated in accordance with Form HUD-92443. The
9 incentive fee computed for Lump Sum construction contracts may not exceed 50% of
10 the amount by which the estimated interest, taxes, property insurance and mortgage
11 insurance premium, exceeds the certified costs for these same items through the
12 actual date of completion.

13 The incentive fee computed for Cost Plus construction contracts may be paid in an
14 amount calculated in accordance with the Incentive Payment Computation on page
15 two of Form HUD-92443. Additionally, when the cost plus contract is used the
16 **contractor may not** receive total payments that exceed: (1) the actual costs of
17 construction, (2) the cash fee provided in the construction contract, or (3) the
18 incentive fee as determined by the computation. (The contractor shall not be paid an
19 incentive fee that is greater than the amount of cost overruns; the contractor must only
20 receive the amount of the incentive fee. Any excess of this amount must be refunded
21 to the borrower.)

22 6. Damages Clause. Apply the damages clause of the construction contract when the
23 general contractor does not complete the project on time. The clause holds the general
24 contractor financially responsible for the added soft costs resulting from the
25 contractor’s delay.

- 1 a. Calculate the amount of actual damages and liquidated damages, using the lesser to
2 determine the adjusted upset price.
- 3 b. To determine actual damages, compute the actual cost of interest, taxes, insurance, and
4 MIP for the period from the scheduled completion date (as amended by HUD-approved change
5 orders) through the substantial completion date.
- 6 c. To determine liquidated damages multiply the daily liquidated damages rate from the
7 construction contract by the number of days between the scheduled completion date specified in
8 the construction contract, as amended by the HUD-approved time extensions, through the
9 substantial completion date.
- 10 d. Reduce the damages by the portion of the net operating income earned during the
11 liquidated/actual damage period.
- 12 e. For those cases where an administrative completion date has been established, use this
13 date for computing damages for cost certification purposes. However, the general contractor is
14 responsible for damages through the date of substantial completion.
 - 15 7. If a borrower acts as its own general contractor:
 - 16 a. A construction contract is not executed. Instead, Form HUD-92441M-Supplement is
17 added to the Building Loan Agreement, Form HUD-92441M.
 - 18 b. The upset price for construction is line 51 of the approved Form HUD-2328,
19 Contractor's and/or Borrower's Cost Breakdown (Schedule of Values), as adjusted by
20 the cumulative effect of HUD-approved change orders and the incentive provision, if
21 applicable.
 - 22 c. Incentive clause, if any, is incorporated by addendum to Form HUD-92441M-Supplement.
 - 23 d. There is no liquidated/actual damages clause.

24 NOTE: The borrower may serve as its own general contractor only when the
25 borrower is an individual or a general partnership.
 - 26 8. Incomplete Minor Items. The borrower's certification of the amount due under the
27 terms of the construction contract may include the cost of minor items of on-site work
28 that remain incomplete under the construction contract.

-
- 1 B. Architect's fee(s) are limited to the amounts paid in cash.
- 2 1. Recognize the cost of additional services set form in Article 10 of the Standard Form
- 3 of Agreement between Owner and Architect for Housing Services, AIA Document
- 4 B108. Ask Architectural and Cost staff to check the reasonableness of these charges.
- 5 2. Disallow:
- 6 a. Any portion of the Architect's fee paid in stock.
- 7 b. Any costs associated with a clerk of the works.
- 8 3. If any identity of interest comes into being between the Architect and either the
- 9 borrower or general contractor during project construction:
- 10 a. See maximum design Architect's fee for cost certification purposes set forth in the
- 11 Agreement and Certification, Form HUD-93305M.
- 12 b. Do not allow a fee for supervisory services to an identity of interest Architect.
- 13 4. Treat any unused balance of the total Architect's fee as a direct mortgage reduction to
- 14 the original mortgage amount on Form HUD-92580.
- 15 C. Interest is allowable in the amount accrued on the first mortgage between initial
- 16 endorsement (start of construction for insurance upon completion projects) and the cut-off date
- 17 defined in Section 13.8.
- 18 1. Recognize interest costs associated with an approved early start provided:
- 19 a. The borrower entered into an agreement with the contractor which:
- 20 (1) Was approved by the Hub Director.
- 21 (2) Agrees to reimburse the contractor for interest on money borrowed for
- 22 construction prior to initial endorsement.
- 23 (3) States that reimbursement will be made only to the extent the borrower has funds
- 24 available in the amount estimated for interest during construction.

- 1 b. The certified amount, when added to the interest cost incurred directly by the
2 borrower, does not exceed the total amount of interest estimated in Section G of Form
3 HUD-92264.
- 4 c. Form HUD-92415, Request for Permission to Commence Construction Prior to
5 Initial Endorsement for Mortgage Insurance, was executed and approved.
- 6 d. Interest costs reflect the contractor's actual cost of money borrowed to cover the
7 cost of construction between the early start date and the initial endorsement as
8 adjusted by paragraph e., below.
- 9 e. Rate of interest does not exceed the rate established for the insured loan.
- 10 2. Interest rate paid on the construction loan cannot exceed:
 - 11 a. For insurance of advances: the rate stated in the Firm Commitment.
 - 12 b. For insurance upon completion: the rate acknowledged by the Hub Director
13 before issuing the Firm Commitment.
- 14 3. Deduct accrued interest forgiven by the lender or otherwise not paid in cash.
- 15 4. Treat lender/bond underwriter's refund of any portion of the construction loan interest
16 to the borrower or sponsor, as a direct mortgage reduction to the original mortgage
17 amount on Form HUD-92580.
- 18 5. If the construction interest rate changes before initial endorsement and it was not
19 feasible to reprocess the project or if tax exempt bonds were sold to finance the
20 construction loan and the true interest rate was not known until cost certification:
 - 21 a. Interest savings may be created from the difference between the processed interest
22 rate and the actual final interest rate.
 - 23 b. Treat these savings as a direct mortgage reduction if the following condition was
24 included in the firm commitment:
25 "Any interest savings resulting purely from a differential between the HUD processed interest
26 rate and the actual construction interest rate may not be construed as excess funds that may be
27 used to offset costs in other categories at the time of cost certification. Any such saving must be
28 applied as a mortgage reduction."
- 29 6. Neither the interest on subordinated liens nor other obligations of the borrower are
30 allowed as certifiable costs.

- 1 D. Taxes are allowable in the amount accrued on the first mortgage between initial
2 endorsement (start of construction for insurance upon completion projects) and the cut-off date
3 defined in Section 13.7. Do not recognize costs accrued during the early start period.
- 4 E. Property insurance is allowed in the amount accrued on the first mortgage between initial
5 endorsement (start of construction for insurance upon completion projects) and the cut-off date
6 defined in Section 13.7. Do not recognize costs accrued during the early start period.
- 7 F. MIP. The FHA Comptroller's office cannot compute the exact amount of MIP due during
8 the construction period until the project has been completed and the Washington Docket
9 forwarded to Headquarters.
- 10 1. For a project involving insurance of advances, allow MIP of 0.5% per annum on the
11 mortgage amount on the basis of accrual for the number of days in the period used to
12 Paragraph C above, when applicable.
- 13 2. For a project involving insurance upon completion, no MIP is paid during
14 construction.
- 15 G. HUD application, commitment and inspection fees are allowable in the amounts paid.
16 Fees paid to reopen an expired or terminated commitment are not allowable costs.
- 17 H. Financing expense includes the initial service charge, discounts fees, GNMA, permanent
18 lender commitment fees, and other similar fees.
- 19 1. Allow the lesser of:
- 20 a. Amounts paid, or to be paid, in cash.
- 21 b. Amounts shown on Form HUD-92434M, Lender's Certificate (formally
22 Mortgagee's Certificate), or Certificate of Lender portion of Form HUD-92455M
23 approved by the Hub Director before Initial Endorsement (Insurance of Advances)
24 or issuance of Firm Commitment (Insurance Upon Completion).
- 25 2. Construction lender's initial service charges (usually 2%). Construction and permanent
26 lenders' fees in the aggregate cannot exceed 3.5% (5.5% for bond financed projects).
27 The combination of origination, financing, and permanent placement fees must include
28 the amount for lender's legal fee and is expected to cover the following:
- 29 a. Processing fees.
- 30 b. All expenses of the lender's counsel paid directly from the initial service charge.
31 (Reconcile separate invoices or bills with the cost of the itemized figures.)
- 32 c. All other charges by the construction lender.

- 1 d. Excludes:
- 2 (1) Construction loan discount.
- 3 (2) Construction loan extension fees.
- 4 e. Any charges made by the lender for payment of counsel services or charge paid
- 5 directly to the lender's counsel, to the extent they cause the initial service charge to
- 6 exceed 2 percent, are not certifiable. *Except*, if charges are related to "Title and
- 7 Recording" expenses certify these under the same category, see Section 13.16.I
- 8 below.
- 9 d. Lender's permanent placement fee is usually 1.5%. It is expected to cover all
- 10 permanent placement expenses except discounts and some of the fees associated
- 11 with a bond financed transaction.
- 12 e. If GNMA Mortgaged Backed Securities are involved, the lender may not assess an
- 13 additional charge for the MBS application fee or for the custodial or delivery fee.
- 14 3. Recognize for cost certification:
- 15 a. Reasonable discounts based on current interest rates at the time of issuance of the
- 16 Firm Commitment for projects involving insurance of advances and insurance upon
- 17 completion charged by the construction and permanent lenders. Recognize
- 18 extension fees charged by the construction lender if funded at initial endorsement
- 19 and shown on the lender's Certificate, Form HUD-92434M (formally Mortgagee's
- 20 Certificate).
- 21 b. Permanent lender extension fees, shown on Form HUD-92434M, if funded before
- 22 the substantial completion date.
- 23 c. For Insurance Upon Completion cases, construction and permanent loan extension
- 24 fees, shown on the Certification of Mortgagee portion of Form HUD-92455M, if
- 25 funded before cost certification cut-off.

- 1 d. Financing fees (including extension fees and discounts) paid on behalf of a
2 borrower by a third party under Paragraph 18(f) of the Lender's Certificate or
3 Paragraph 10h of Certificate of Lender portion of Form HUD-92455M and shown
4 as a current liability on the borrower's balance sheet to the extent there are savings
5 in the mortgage. At final endorsement, require a promissory note be used for any
6 unpaid balance of the obligation recognized in cost certification.
- 7 e. For bond financed projects, cost of issuance, discounts, and financing fees in excess
8 of 5.5%; provided the cost certification evidences that the sponsor/borrower cannot
9 benefit monetarily from excess investment income from the proceeds of the
10 invested obligations. Refer to Section 8.15.
- 11 5. Do not recognize for cost certification:
 - 12 a. Any "side deals" (except for approved discounts) by which the borrower agrees to
13 pay additional sums.
 - 14 b. The 4% construction loan and 1.75% permanent loan GNMA indemnification
15 escrows.
 - 16 c. Discounts required to buy down the construction and/or permanent rate to a below
17 market rate.
- 18 6. Treat the following as a direct mortgage reduction at final endorsement:
 - 19 a. Premiums paid by lender to the borrower or sponsor for acquiring the construction
20 or permanent loan.
 - 21 b. Partial refunds of the Commitment fee allowed in processing, which are returned to
22 the borrower or sponsor.
 - 23 c. Discounts or other fees paid for by a contribution of a portion of the initial service
24 charge by the lender/bond underwriter.
 - 25 d. Rebates paid to a borrower or sponsor by the lender/bond underwriter for bond -
26 financed mortgages.
- 27 I. Title and recording expense is limited to cash paid for:
 - 28 1. Title search and policy at the time of initial endorsement;
 - 29 2. Recording fees at initial endorsement;
 - 30 3. Mortgage and stamp taxes;

- 1 4. Survey recording fees;
 - 2 5. Updating title policy during construction;
 - 3 6. Final title policy and recording charges; and
 - 4 7. Legal fees incurred with any of the above.
- 5 J. Legal, organization and audit expenses are limited to expenses incurred in organizing the
- 6 borrower entity, developing the proposal to submit to HUD and other necessary
- 7 governmental agencies and required services during closing and construction.
- 8 1. Organizational allowance:
- 9 a. Allow only the amount included in Section G of Form HUD-92264 for the
- 10 organizational fee, unless the borrower, which justifies the need for, and
- 11 reasonableness of the additional expenditure submit fully supporting documentation.
- 12 b. Any costs incurred in excess of this allowance are not eligible for recognition in
- 13 processing a mortgage increase or the equity computation on Form HUD-92580.
- 14 2. Limit the borrower's legal expenses to those incurred for: initial through final
- 15 closings, tax advice during organization of borrower entity only, and preparation of
- 16 documents and representation for and during organization of the borrower entity.
- 17 a. Allow customary expenditures expected to be incurred before and during initial
- 18 closing, construction period, and final closing.
- 19 b. Do not allow:
- 20 (1) Expenses connected with land acquisition which is already included in, or
- 21 contributing to:
- 22 (a) Title and recording expense.
- 23 (b) Estimated market price of site.
- 24 (c) Obtaining changes in zoning.
- 25 (2) Cost of legal services to create tax shelters, trusts, etc.
- 26 3. Recognize cost of a "package deal" for organization and legal services provided:

- 1 a. Supplier is qualified to furnish the needed services.
- 2 b. Do not allow duplicate credit for the same services.
- 3 4. Audit fee covers the cost of the accountant's audit and opinion of the borrower's
- 4 certificate of costs.
- 5 5. Amounts included in Form HUD-92264 for legal and audit expenses are not blanket
- 6 allowances, but ordinarily set an upper limit on allowable amounts.
- 7 a. Non-typical fees must be borne by the borrower, unless in an exceptionally
- 8 complex case, a higher fee is proven by the borrower to be necessary and
- 9 reasonable. Detailed invoices and/or other documentation is required as to the
- 10 reasonableness, purpose, necessity and proper classification of all items in the
- 11 category.
- 12 b. This limitation is not flexible where a "package" for legal and organizational
- 13 services is involved or where a substantial amount of the legal and organizational
- 14 services are performed by the same firm.
- 15 K. Offsite Costs. Where the borrower enters into a supplemental contract for constructing
- 16 offsite improvements, allow the lesser of:
 - 17 1. Contract price as adjusted by the HUD's estimated cumulative effect of approved
 - 18 offsite change orders.
 - 19 2. Actual cash paid or to be paid for offsite work.
 - 20 3. Amount allowed by cost analyst for offsite construction of Form HUD-92331,
 - 21 Summary of Cost Certification Review - Cost Section.

22 NOTE:

- 1 a. The Valuation Branch must adjust the as-is land value of the property, if the allowed
2 amount for offsite and demolition differs from HUD's estimate on Form HUD-92264 issued at
3 Firm Commitment.
- 4 b. Offsite costs are not allowable for leasehold estates when the ground rent is based on a
5 land value that reflects all required offsite improvements since the borrower has not paid for
6 those improvements.
- 7 c. If the borrower certifies to off-site costs, the land value entered on Form HUD-92580,
8 "Maximum Insurable Mortgage" will be reduced by the amount of off-site costs.
- 9 L. Other costs include all costs and/or recovery of costs which are not provided for
10 elsewhere and which are clearly attributable to the actual cost of the project.
 - 11 1. Cost of acquiring the leasehold interest provided the acquisition cost plus ground rent
12 and offsite costs paid by the borrower, if any; do not exceed the HUD Fair Market
13 Value of the Land Fully Improved. Any excess is to be reflected as a disallowed cost
14 of acquiring the leasehold.
 - 15 2. Ground rent paid during the period of the first mortgage between initial endorsement
16 (start of construction for insurance upon completion projects) and the cut-off date as
17 defined in Section 13.7.
 - 18 3. Incentive payment due a nonidentity of interest contractor for completing
19 construction before the scheduled completion date as amended by HUD-approved
20 change orders.
 - 21 4. Compensation from an insurance claim including any income earned by investing the
22 proceeds of the claim. Treat as recovery of cost after computing BSPRA.
 - 23 5. Contractor's bond premium if paid by the borrower. If the construction contract
24 contained an amount for the bond premium, subtract it from the contract amount
25 when developing the adjusted upset price on line 1c of Form HUD-92331A.
 - 26 6. Other fees, including engineering and topographical survey. Cost staff must
27 determine if such costs are reasonable and not duplicated in the general contractor's
28 costs.
 - 29 7. Contingency reserve is included in the replacement cost of substantial rehabilitation
30 projects.

-
- 1 a. The contingency reserve may be used for unforeseen costs of necessary change orders
2 approved by HUD and unanticipated soft costs for time extensions approved by HUD.
- 3 b. Expenditures for change orders and shortfalls in soft costs should be certified to and
4 allowed under those specific line items.
- 5 c. Normally there will not be an amount certified to under contingency reserve since all
6 expenditures will be certified to on other line items.
- 7 d. An itemization of all expenditures covered by contingency reserve funds must be
8 attached to the cost certification submission.
- 9 8. Grants, governmental loans or tax credit equity used to pay for allowed cost items.
- 10 a. Should be treated as a recovery of cost after BSPRA.
- 11 b. Do not deduct grant, loan or tax credit equity funds from the total recognized costs when
12 the funds were used to pay for the non-replacement cost items, i.e., used toward but not limited
13 to: paying the acquisition cost of the land in excess of the HUD allowance, the operating deficit,
14 working capital and items on Form HUD-2880, Applicant/Recipient Disclosure.
- 15 9. Residential relocation fund established on Form HUD-92264. Allow only those
16 expenses approved by the HUD CPD relocation specialist up to the amount
17 established on Form HUD-92264. Apply unused allowance as a direct mortgage
18 reduction.
- 19 10. Third Party costs for appraisals, market analysis, PCNA etc., are no longer recorded
20 in Other Fees and should be included with Organizational Cost line items (refer to
21 Chapter 3).
- 22 M. BSPRA
- 23 1. HUD does not control the division of BSPRA.
- 24 2. Compute BSPRA without regard to amounts on Form HUD-92264 based on a
25 percentage of allowed costs.
- 26 a. Use the same percentage (not to exceed 10%) in the Firm Commitment review.
- 27 b. Exclude from the computation the cost of off-site work, land, payments for acquisition of
28 leasehold, ground-rent, relocation expenses, and supplemental management funds, and Major
29 Moveable Equipment, if applicable.
- 30 3. 50/75% rule.

- 1 a. Whether or not there is an identity of interest, no general contractor's fee (general
2 overhead and profit) will be allowed when:
- 3 (1) More than 50% of the contract sum in the Construction Contract–Cost
4 Plus, Form HUD-92442M, is subcontracted to one subcontractor,
5 material supplier or equipment lessor, or
- 6 (2) 75% or more with three or less subcontractors, material suppliers and
7 equipment lessors.
- 8 NOTE: If two or more subcontractors have common ownership, they are considered
9 as one subcontractor.
- 10 b. Exceptions: The 50/75% rule is not applicable to:
- 11 (1) Manufacturers of Industrialized Housing.
- 12 (2) Trade items performed by persons on general contractor's payroll.
- 13 (3) Supplemental Loan program.
- 14 (4) Rehabilitation programs other than substantial rehabilitation.
- 15 c. The cost analyst determines the applicability of the 50/75% rule.
- 16 d. Where the 50/75% rule is violated, the general contractor forfeits its profit and only
17 Sponsor's Profit Risk Allowance (SPRA) is allowed.
- 18 4. Where there is no identity of interest between the borrower and builder or when the
19 50/75% rule has been violated, compute a SPRA which is 10% of allowable:
- 20 a. Architectural fees.
- 21 b. Carrying charges and financing.
- 22 c. Legal, organization, and audit expenses.
- 23 5. If an identity of interest between the borrower and general contractor is established
24 after initial endorsement and exists at the time of substantial completion, BSPRA is
25 allowed in lieu of a builder's profit and SPRA.
- 26 6. If prior to the substantial completion date an identity of interest no longer exists
27 between the borrower and builder, substitute SPRA for BSPRA.

- 1 a. The construction contract may be amended to permit a typical builder's profit.
- 2 b. Treat the difference between BSPRA and the combination of SPRA and builder's profit
- 3 as a direct mortgage reduction on Form HUD-92580.
- 4 N. Non-Profit Developer Fee. The allowable amount is included in the Firm Commitment
- 5 less amounts certified and allowed on other line items.

6 **13.17 Cost Review of Contractor's Cost Certification**

- 7 A. Actual costs are all costs, paid by the general contractor under the Construction Contract
- 8 for completion of the project, and to which the general contractor certifies, using Form HUD-
- 9 92330A.
 - 10 1. Include actual costs paid in cash, or to be paid in cash (such as items of delayed
 - 11 completion), within 45 days after the date of the substantial completion, for
 - 12 labor, materials, equipment, subcontract work, general requirements (job
 - 13 overhead), fees and general overhead. Also include amounts estimated for any
 - 14 items requiring an escrow.
 - 15 a. *General Requirements:*
 - 16 (1) May include salaries of clerical staff for time actually spent at the project
 - 17 site. Prorating of annual salaries on the percent basis is not permitted.
 - 18 (2) Salaries of executives may not be included in General Requirements. Such
 - 19 salaries are included in General Overhead.
 - 20 b. *General Overhead:*
 - 21 (1) Include only the amount of the accepted Schedule of Values, Form HUD-
 - 22 2328, adjusted by the effect of approved change orders.
 - 23 (2) Itemization is not required.
 - 24 2. Kickbacks, rebates, adjustments, discounts, or any other devices which the contractor
 - 25 may have received or is entitled to, must be deducted from actual costs.
 - 26 B. For those cases where the borrower is not seeking a mortgage increase or a detailed
 - 27 review is not requested by the Hub Director:
 - 28 1. The cost analyst will not review Form HUD-92330A, Contractor's Certificate of
 - 29 Actual Cost, in assisting the Mortgage Credit Examiner in the analysis of the
 - 30 borrower's cost certification.

- 1 2. The cost analyst will advise Mortgage Credit Examiner of the approved change
- 2 orders.
- 3 C. Cost Review
- 4 1. Conduct a detailed review when the borrower applies for a mortgage increase or the
- 5 Hub Director orders a detailed review.
- 6 2. Review certifications where required from the contractor, or any subcontractor,
- 7 equipment lessor, material supplier or manufacturer of industrialized housing.
- 8 3. Forms necessary to make reviews:
- 9 a. Form HUD-92330, Borrower's Certificate of Actual Cost.
- 10 b. Form HUD-92330-A, Contractor's Certificate of Actual Cost.
- 11 c. Form HUD-93305M, Agreement and Certification.
- 12 d. Form HUD-92437, Request for Construction Changes–Project Mortgages.
- 13 e. Form HUD-92326, Project Cost Estimate (HUD Estimate).
- 14 f. Form HUD-2328, Contractor's and/or Borrower's Cost Breakdown.
- 15 g. Form HUD-92331-B, Cost Certification Review Worksheet.
- 16 h. Form HUD-92331, Summary of Cost Certification Review.
- 17 i. Form HUD-95379, Trip Report.
- 18 4. Steps to conduct the review:

- 1 a. 50/75% rule check. Use information from the “total” and “name of subcontractor or
2 payee” columns of the general contractor’s cost certification. If the rule applies, disallow the
3 general contractor’s general overhead and profit. If the project uses BSPRA, disallow only
4 the general overhead and inform the Mortgage Credit Examiner.
- 5 b. Identity of interest subcontract review (for borrower, general contractor, subcontractors,
6 equipment lessor, material suppliers, and industrialized housing manufacturers):
- 7 (1) Examine Form HUD-93305M and Form HUD-92330-A to establish all
8 declared identities of interest.
- 9 (2) Review each identity of interest subcontractor’s cost certification.
10 NOTE: If cost certification not received, disallow subcontractor’s overhead,
11 profit, and all questionable costs.
- 12 (a) If no prior approval as an identity of interest subcontractor,
13 disallow subcontract overhead and profit.
- 14 (b) For prior approval:
- 15 (i) Allow prior approved subcontract overhead and profit, plus
16 or minus the effect of approved change orders. Disallow
17 excess.
- 18 NOTE: Do not reduce the prior approved subcontract overhead and
19 profit in the event that the certified cost for the work is less than the
20 prior approved maximum subcontract price.
- 21 (ii) Allow up to the prior approved maximum subcontract
22 amount for work, plus or minus the effect of approved
23 change orders. Disallow excess.
- 24 5. Trade line item review:
- 25 a. On Form HUD-92331-B
- 26 (1) Enter all trade line costs from HUD estimate (Form HUD-92326) or
27 Contractor’s schedule of values (Form HUD-2328) after adjusting for
28 approved change orders.

- 1 (2) Enter all trade line costs from general contractor's cost certification (Form
2 HUD-92330-A). Take architect's fees from borrower's cost certification
3 (Form HUD-92330).
- 4 (3) Using dollar and percentage variance columns compare each trade's actual
5 cost with the estimate. Determine allowable amounts.
- 6 b. Allowable amounts are not limited by the estimates. Analyze differences.
 - 7 (1) Allow actual costs paid to complete the work in accordance with the
8 construction contract.
 - 9 (2) Allow actual costs due to unusual circumstances, e.g., subcontractor
10 bankruptcy, code changes, required replacement of completed work,
11 replacements due to natural occurrences (storms, floods, earthquakes,
12 etc.).
- 13 c. Question only amounts substantially in excess.
 - 14 (1) Contact general contractor and/or borrower requesting explanation or
15 more documentation.
 - 16 (2) Make disallowances if explanation/documentation is not received in a
17 reasonable amount of time.
 - 18 (3) Only the accountant may make reallocation of monies from one trade item
19 to another.
 - 20 (4) As a result of discussion, have the accountant amend Form HUD-92330-A
21 and resubmit.
- 22 d. Disallow any amount not justified or supported as being part of the construction contract
23 work.
- 24 e. Disallow costs for duplication of work due to contractor's error or negligence, e.g.,
25 improper placement, failure to protect, noncompliance with contract, etc.
- 26 D. Summary of Cost Certification Review on Form HUD-92331
 - 27 1. Enter all recommended disallowances.
 - 28 2. Enter summary of construction contract costs.
 - 29 3. Enter contractor's profit from borrower's Form HUD-92330. Add profit from all
30 HUD approved change orders.
 - 31 4. Enter offsite costs from borrower's Form HUD-92330, if applicable.

- 1 a. Review itemized offsite breakdown.
- 2 b. Disallow any cost duplication on general contractor's Form HUD-92330-A.
- 3 5. Property Insurance Schedule, Form HUD-92329. Complete new form using allowed
- 4 construction costs.
- 5 E. Lump Sum Construction Contract Cost Certification
- 6 1. Review borrower's certification (Form HUD-92330) if requested to do so by Hub
- 7 Director.
- 8 2. Review cost certification of any subcontractor that has identity of interest with the
- 9 borrower.

10 **13.18 Determination of the Nonprofit Borrower's Initial Equity**

11 **Investment**

12

13 The nonprofit borrower under the Section 221(d)(3) will be permitted a 6% return on its initial
14 equity as computed on Form HUD-92580, Maximum Insurable Mortgage.

- 15 A. The base equity is determined as follows:
 - 16 1. New Construction: Line 6, Form HUD-92580, minus finally endorsed mortgage
 - 17 determined in line 10 of the form.
 - 18 2. Rehabilitation–Property Owned: Reduce the sum of line 4, Form HUD-92580, plus
 - 19 HUD's estimate of the "as is value" of the existing land and improvements before
 - 20 rehabilitation, by the finally endorsed mortgage determined in line 10 of the form.
 - 21 3. Rehabilitation–Property Acquired: Reduce the sum of line 4, Form HUD-92580, plus
 - 22 the lesser of HUD's estimate of the "as-is value" of the existing land and
 - 23 improvements before rehabilitation or the acquisition cost of the property, by the
 - 24 finally endorsed mortgage determined in line 10 of the form.
 - 25 4. Rehabilitation under Section 220 and 221(d): Use the New Construction formula in
 - 26 paragraph A.1 above.
- 27 B. The base equity computed in paragraph A.1 above may be increased by:
 - 28 1. The cost of furnishing, equipment or other betterments essential to the operation of the
 - 29 project.
 - 30 2. The nonprofit developer's fee used to reduce the estimate closing costs of the project.
 - 31 3. Grants from national, regional, and local community service organizations (non-
 - 32 government source).

13.20 Section 223(f) Modified Form of Cost Certification

A. Complete and submit a modified form of cost certification for review 15 days before the initial/final endorsement of the loan for insurance for all projects processed pursuant to Section 223(f); except those 207/223(f) refinancing transactions where 80% or less of value is the controlling criterion. (In such case cost certification is not required.) Unlike other cost certification procedures, savings from one line item cannot offset cost overruns on another line item. As you complete the cost certification and there is a cost savings, you must recalculate the maximum insurable mortgage. Refer to Form HUD-2205-A's instructions.

1. The borrower must certify to the total actual costs incurred in the acquisition or refinancing of the property. The certification must be submitted on Form HUD-2205-A, and it must be dated and signed by an authorized agent of the borrower.
2. The mortgagee must submit the certification to HUD for computation of the maximum insurable mortgage and completion of Section II of Form HUD-2205-A.
3. If, in a purchase transaction, the amount of the acquisition cost determined allowable at cost certification exceeds the estimate of value, which was determined during processing, the rent formula shall be recomputed. This re-computation may be accomplished using the allowable acquisition cost as determined by cost certification and the dollar amount of secondary financing represented by the approved promissory notes (Form HUD-92223).

B. The borrower must submit a supplemental for deferred repairs cost certification where an escrow was established at initial/final endorsement to complete non-critical repairs. In cases where the actual costs are less than estimated, you must recalculate the maximum insurable mortgage. If the maximum insurable mortgage is reduced because of the lower actual costs, the borrower must either:

1. Provide the required prepayment to the mortgagee, or
2. Have the required prepayment deducted from the repair escrow.

13.21 Special Instructions for Substantial Rehabilitation

NOTE: Cost certification instructions (set by statute) dictate that the lesser of the "as is" value of the land and improvements (before repair or rehabilitation) or the purchase price of the land and improvements, is used in the cost build up for criterion 3 of Form HUD-92264-A, in substantial rehabilitation cases. Consequently, when mortgage proceeds will be used to fund the acquisition of the property, the "as is" value estimation will be used

1 as a test of the reasonableness of the acquisition price.

2
3 When the acquisition price is less than the “as is” value of the land and improvements (as
4 accepted by HUD), and mortgage proceeds will be used to fund the acquisition of the
5 property, the acquisition price will be used in the cost build up for criterion 3 forming the
6 cost basis for the firm commitment.

7
8 When the acquisition price exceeds the “as is” value of the land and improvements (as
9 accepted by HUD), and mortgage proceeds will be used to fund the acquisition of the
10 property, then the “as is” value will comprise the basis of the cost build up for the firm
11 commitment.

12
13 When mortgage proceeds will not be used to fund the acquisition of the property, the “as
14 is” market value of the property will be used in the cost build up for criterion 3 forming
15 the cost basis for the firm commitment. This is particularly significant when below
16 market rent restrictions, (such as in the case of LIHTC limited rents or Section 8 rent
17 subsidy) are in place and the use of market rents in valuing the property will result in a
18 premium over these rent restrictions. (See Section 7.10.A.9, defining how market rents
19 are derived as the basis for the “as is” value).

20 21 **13.22 Mortgage Reduction after Cost Certification**

22 A. The National Housing Act requires that the mortgage will not exceed the applicable
23 percentage of actual costs. If certified actual costs are lower than original projected cost as
24 reflected in Form HUD-92264, a reduction in mortgage may be applicable. The Agreement
25 and Certification, Form HUD-93305M, also addresses this issue and provides that where
26 the HUD accepts, for cost certification, estimates of cost for any item, the later substitution
27 of certified actual costs may require a reduction of the mortgage.

28 B. Reductions of cost may arise from:

- 29 1. Refunds, rebates, or discounts.
- 30 2. Excess of escrows over the actual costs of incomplete construction items.
- 31 3. Refunds of deposits made by the borrower to prevent losses to the mortgagee from loss
32 in connection with sale of the mortgage.
- 33 4. Settlement of claims against bonding companies or others after project completion.

34 C. At final endorsement, the borrower must set up a cash escrow to pay all "to be paid in cash
35 items" identified on Form HUD-92330, Borrower's Certificate of Actual Cost, and debts to

1 third parties who made the original disbursement for an item listed as paid on Form HUD-
2 92330.

3 1. Reconcile the difference between:

4 a. Obligations listed on Form HUD-92023M, Request for Final Endorsement of
5 Credit Instrument or HUD-92455M (for Insurance upon Completion Projects only),
6 and

7 b. The "to be paid" column on Form HUD-92330 plus debts to third parties.

8 2. Paid receipts must support differences and a statement from the borrower identifying by
9 name and cost, those items paid in cash. The receipts and statement are affixed to
10 Forms HUD-92023M or HUD-92455M.

11 3. Do not accept personal or business checks issued by the borrower at final endorsement
12 as evidence of payment. Payment must be in certified or cashier checks.

13 4. Prepare a new Form HUD-92331A to disallow obligations listed as "paid" or "to be
14 paid" on Form HUD-92330, which are represented at final endorsement as paid by
15 HUD-approved notes. Prepare a new Form HUD-92580 from the total of HUD-
16 approved cost of revised Form HUD-92331A.

17 5. Undisbursed mortgage proceeds may supplement or satisfy the cash escrow.

18 6. Use Form HUD-92476.1M, Escrow Agreement for Non-Critical, Deferred Repairs
19 (formally Escrow Agreement for Unpaid Construction Costs):

20 a. To set up the cash escrow.

21 b. Attach a detailed listing of the unpaid costs.

22 7. Use Form HUD-92464M, Request for Approval of Advances of Escrow Funds to disburse
23 escrow.

24 8. Escrow should be disbursed within 45 days after final endorsement. If all of the funds
25 are not disbursed follow the procedures in Section D below.

26 9. At final endorsement, if all obligations have been paid in cash, nothing else is needed.

27 D. Sixty-days after final endorsement:

28 1. Prepare a new Form HUD-92331A. Enter under the column heading:

29 a. "92264" - the amount of each item of cost recognized from the earlier Form HUD-
30 92331A "Allowed" column.

31 b. "92330/92330A" - the amount listed in Column C of the Borrower's Certificate of
32 Actual Cost, Form HUD-92330, for each item of cost.

- 1 c. "Allowed" - the amounts paid in cash based on the reconciliation performed in
2 Section B above and disbursements from the cash escrow account.
- 3 c. "Disallowed" - the lower of the amounts previously allowed or paid in cash.
- 4 2. Compute a new Maximum Insurable Mortgage, Form HUD-92580, based on the total
5 of the "Disallowed Column" (Form HUD-92331-A). If this computation produces an
6 amount less than the mortgage finally endorsed:
 - 7 a. Notify the Directors of Housing Production and Management by memorandum that
8 prepayment to the mortgage is required.
 - 9 b. Prepayment is mandatory and is applied:
 - 10 (1) In amounts equal to the scheduled monthly principal payments, to the extent
11 possible.
 - 12 (2) Any remainder goes to the Reserve for Replacements Fund.
 - 13 c. If HUD is notified that payment has been delayed because of a dispute or litigation,
14 retain funds to pay the amount pending resolution of the dispute.
 - 15 d. Notify the mortgagee or escrow agent by letter of the required prepayment.
 - 16 e. Control the remaining balance in a special account, as a reserve for unpaid construction
17 costs from which disbursements may be made only after written consent of the
18 Regional Center or Satellite Office.
- 19 3. The mortgagee will continue to use the existing amortization schedule for servicing
20 the mortgage.
 - 21 a. The prepayment is in addition to the regular monthly payments to principal.
 - 22 b. There is no adjustment in the amount of the annual MIP due because of these
23 mandatory prepayments.
- 24 4. The escrow requirement does not apply to funds the general contractor owes.
25 However, the general contractor must submit a reconciliation of its "to be paid" items.

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13.23 Increase in Mortgage Amount

- A. Timing. Requests for a mortgage increase will not be considered until the project is complete, cost certification has been submitted, and the Final Endorsement will likely be achieved immediately following processing of the mortgage increase and the conditions in paragraph B below are met.
- B. Bases for considering a mortgage increase:
1. Necessary changes that arise from differing site conditions (as defined in the construction contract).
 2. Compliance with local codes.
 3. Unforeseen conditions that might affect the safety and health of occupants.
 4. Betterment changes that are economically justified e.g., those that produce significant cost savings to project operation can be reflected in increased income expectancy, or enhance the security of the mortgage.
 5. C. Costs caused by extensions in construction time, when such extensions: are approved by HUD; justifiable under AIA General Conditions; and caused by problems beyond the contractor's control.
 6. D. Other costs not known at Firm Commitment resulting from requirements of local authorities and beyond the borrower's control.
 7. E. Construction hard cost increases caused by a natural disaster declared by Federal or State government, to the extent not covered by casualty insurance.
 8. F. Increased costs resulting from concealed subsurface site conditions, provided it is determined those exploratory tests during project design were sufficient and thorough and neither the architect nor engineer was at fault.
 9. G. Cost of substituting a general contractor when the original general contractor is terminated for cause and the surety has failed to perform.
 10. H. To correct a substantial HUD error in the original processing that would otherwise result in serious inequities.
 11. I. Any mortgage increase for an insured project must be more than 2.5% of the original mortgage and at least \$50,000.

13.24 Restrictions on Mortgage Increases

- A. A mortgage increase may not be granted for cost overruns associated with: completion of the work in accordance with the original contract documents by the original contractor, changes made primarily for the convenience of the borrower or contractor, nor for the aggrandizement of the borrower or contractor.
- B. Cost overruns are not a basis for granting a borrower's request for mortgage increase nor are changes made primarily for the convenience or aggrandizement of the borrower or contractor.
- C. Any mortgage increase for an insured project must be more than 2.5% of the original mortgage and at least \$50,000.
- D. The increase must be supported by net income under Criterion 5 of Form HUD-92264-A.
- E. A mortgage increase may not be granted for replacing a contractor where the borrower sets up a "straw contractor" for purposes of BSPRA.

13.25 Processing a Mortgage Increase

Technical processing consists of Step One through Step Four below. The four steps to processing a mortgage increase, depending on the condition being considered:

- A. Step One: Use the alternative applicable to the condition being considered:
1. Alternative One, applicable to necessary and betterment change order cost increases:
 - a. Architecture and Valuation staffs review the change orders to determine eligibility for processing a mortgage increase. Architecture further reviews for the added cost.
 - b. Mortgage Credit computes the allowable costs on Form HUD-92331-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.d. Reduce this amount by the cost attributable to any change order(s) not qualifying for a mortgage increase.
 - c. The adjusted hard cost forms the basis of the mortgage increase computation
 2. Alternative Two, applicable to contract time extension soft cost increases:

-
- 1 a. Mortgage Credit computes the allowable costs on Form HUD-92331-A, Cost
2 Certification Review Worksheet–Mortgage Credit Staff, Line 3 through 6.
- 3 b. The adjusted soft cost forms the basis of the mortgage increase computation.
- 4 3. Alternative Three, applicable to construction contract cost increases due to a change
5 in the contractor:
- 6 a. *A&E staff computes a new Form HUD-2328 and Form HUD-92264, Section G through*
7 *Line 50.*
- 8 b. *Mortgage Credit staff computes the allowable costs of Form HUD-92331-A, Cost*
9 *Certification Review Worksheet–Mortgage Credit Staff, Line 1.c. for hard cost increases between*
10 *the original contractor and the contractor completing the work, and Lines 3 through 6 for soft*
11 *cost increases associated with the change in contractor.*
- 12 c. *The adjusted hard and soft costs form the basis of the mortgage increase computation.*
- 13 4. Alternative Four, applicable to substantial error in HUD cost processing:
- 14 a. *A and E staff computes a new Form HUD-2328, and Form HUD-92264, Section G*
15 *through line 50.*
- 16 b. *Mortgage Credit computes the allowable costs on Form HUD-92231-A, Cost*
17 *Certification Review Worksheet–Mortgage Credit Staff, Line 1.c, using the criteria in paragraph*
18 *c. below.*
- 19 c. *The allowable construction costs for processing the increase will be based upon the*
20 *lesser of:*
- 21 (1) The amount of the construction cost certified by the borrower, or
- 22 (2) The upset price of the construction contract as adjusted by approved
23 change orders eligible for a mortgage increase, plus the increases resulting
24 from correcting or errors in the original processing.
- 25 d. *The adjusted hard cost forms the basis of the mortgage increase computation.*
- 26 **NOTE:** The mortgage credit examiner must not use the adjusted upset price of the
27 construction contract as a limiting criterion at cost certification where there is a
28 substantial error in HUD cost processing.

1 B. Step Two: Mortgage Credit must compute (for use by Valuation in completing Form
2 HUD-92264) the eligible costs and fees for the following: architect's fees, bond premium if
3 paid by the borrower, other fees not included in the construction contract and paid by the
4 borrower, interest, taxes, insurance, developer's fee (if applicable), legal, organizational and
5 audit fees, marketing (if applicable), offsite costs, as-is land value and "as-is" value of property
6 (if applicable). Mortgage credit must comply with the following in computing the costs and
7 fees.

- 8 1. Do not increase BSPRA or restore Contingency Reserve or nonprofit's Developer's
9 Fee.
- 10 2. Do not include non-mortgageable items (construction or permanent loan extension
11 fees; discount rate, maintenance fees, etc.)
- 12 3. Offset non-mortgageable items by net income (net non-proprietary income, if
13 applicable) to offset amount of mortgage increase, and
- 14 4. For increases caused by natural disaster:
 - 15 a. Consider in the revised cost any increases from any interim closing for: carrying
16 charges, financing fees, and legal fees. Do not include any cost due to construction
17 delays before the disaster,
 - 18 b. Cut the new estimated replacement cost by the amount of any actual recovery
19 through insurance proceeds, and
 - 20 c. Require prepayments to be made for any late recovery of insurance proceeds.

21 C. Step Three. Valuation must use the costs and fees developed by Mortgage Credit in Step
22 Two in revising Form HUD-92264. Valuation must consider each of the following:

- 23 1. Examination fee, initial service fee, GNMA fee, inspection fee, MIP, and title and
24 recording based on the approvable increased mortgage amount.
- 25 2. Net income derived from market rent, expense and occupancy estimates current as of
26 the date of mortgage increase processing.

27 D. Step Four. Mortgage Credit must prepare a revised Form HUD-92264-A, using the
28 revised Form HUD-92264 and Trial Form HUD-92264-A prepared by Valuation in Step Three.

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13.26 Authorization to Reopen Mortgage Transaction

A. The lender must advise the mortgagee of HUD's approval or denial of the request for a mortgage increase upon completion of technical processing. Use Specimen Letter–Agreement Authorizing Reopening of Mortgage Transaction (Appendix 14A), to notify the mortgagee, where a determination is made to increase the mortgage.

1. Approval of a mortgage increase is subject to the payment of the following fees based on the amount of the increase.
 - a. *Application Fee of \$3.00 per thousand of the increase.*
 - b. *Inspection Fee of \$5.00 per thousand of the increase is applicable only when the increase involves construction hard costs.*

13.27 Deferment of Principal Payments

The lender must obtain an agreement from the investor in the GNMA security and support the request for deferment of principal payments.

A. HUD may consider requests for deferment if:

1. There is a delay in construction; or
2. The project requires additional time to reach sustaining occupancy.

1 B. HUD may approve the request when:

2 1. There are sufficient funds outside the mortgage proceeds for payment of
3 interest overrun as confirmed either:

4 a. Written assurance from the sponsor, or

5 b. Exercise of action against the contractor.

6 2. The borrower shows reasonable effort to complete construction and attain
7 sustaining occupancy.

8 C. The period of deferment is the additional time necessary for the borrower to
9 stabilize its operation.

10 D. Deferment Letter. Use Appendix 13B, Specimen Letter – Agreement Authorizing
11 Deferment of Principal Payments for Level Annuity Monthly Payment, and distribute
12 copies in accordance with Section 13.28 below.

13 E. Deferment Instruments. The Hub Director is authorized to approve modifications
14 of the principal and interest payment as may be necessary to effect the deferment of
15 principal payments.

16 **13.28 Document Distribution**

17 A. Form HUD-92580, Maximum Insurable Mortgage.

18 1. Mortgagee—original and one executed copy.

19 2. One executed copy to each of the following: Closing Attorney, Mortgage Credit
20 Control File, Washington Docket, Regional Center or Satellite Office Docket,
21 Regional Center or Satellite Office Valuation Data Bank.
22

- 1 B. Cost Certification Documents. Original documents filed in the Washington Docket and
2 one copy in the Regional Center or Satellite Office Docket.

3 **13.29 Office of Inspector General**

4 The Hub Director should refer borrowers to the Office of Inspector General to evaluate the
5 borrower's and/or contractor's books where discrepancies appear to arise from other than
6 inadvertent error, or creditable misinterpretation of applicable criteria. Do not issue Form HUD-
7 92580, Maximum Insurable Mortgage, before completion of an OIG audit or investigation
8 initiated before its issuance. A referral must also be requested for any indicated fraud or material
9 misrepresentation detected after issuance of Form HUD-92580.

10 **13.30 Cost Certification Incontestability**

11 After HUD approves the certifications and issues Form HUD-92580, Maximum Insurable
12 Mortgage, they are final and incontestable unless there is fraud or material misrepresentation by
13 the borrower, general contractor, or subcontractors.

14 **13.31 Post Closing Escrows**

15 Post-Closing Escrows must be set up at final closing to pay all "to be paid in cash" items
16 identified on Form HUD-92330, Borrower's Certificate of Actual Cost, and debts to third parties
17 who made the original disbursement for an item listed as paid on Form HUD-92330. These
18 amounts may be adjusted for payments made between the cut-off date and the date of final
19 closing.

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Chapter 14

Low Income Housing Tax Credit (LIHTC) and Other Tax Credit Program Guidance

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10 **14.1 Introduction**

11 The Low Income Housing Tax Credit (LIHTC) program was enacted as part of the Tax Reform
12 Act of 1986 and is administered by the Treasury Department and the State Housing Finance
13 Agencies (HFAs). In July 2008, the Housing and Economic Recovery Act (HERA) changed
14 FHA multifamily programs to facilitate the use of insured mortgages with LIHTC developments,
15 in an effort to increase affordable housing production.

16 This chapter outlines policies and procedures for underwriting and reviewing FHA multifamily
17 mortgage insurance applications for projects using Low Income Housing Tax Credits. Standard
18 processing of such applications applies except as modified below, and all Tax Credit projects are
19 underwritten using the “single underwriter model” to meet timeframes of the Tax Credit
20 Program. Underwriters assigned Tax Credit Projects must have specialized training for Tax
21 Credit Project underwriting, but are referred to below simply as “HUD Underwriters.”
22 Guidance provided here addresses all LIHTC projects underwritten for FHA insurance but
23 additional, separate guidance is also provided for LIHTC projects that are processed through the
24 FHA Tax Credit Pilot Program, referred to using the full program name or as “the Pilot
25 Program.”

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30 **14.2 Affordable Housing Underwriting and Program Guidance In** 31 **Other Parts of the MAP Guide**

32 Guidance for processing and underwriting insured loans for affordable housing projects under
33 the various mortgage insurance programs can be found in several other chapters of this Guide,
34 noted in the chart below:

MAP Guide Section Number	Content
Section 2.7	Identities of Interest are permitted between lenders and equity syndicators, investors or bridge loan lenders, in limited circumstances.
Sections 3.2 & 4.2.C.	Tax Credit projects usually go “direct-to-firm”, but if two stage processing is used, no pre-application fees are charged for LIHTC or other affordable projects.
Section 3.5	Loan sizing ratios under 221(d)(4) are provided, and these apply to Tax Credit projects underwritten for that program, unless adjusted for the FHA Housing Tax Credit Pilot Program in separate, future guidance.
Sections 3.7, 3.8 & 3.9.	Loan sizing ratios under 220, 223 and 231 are provided, and these apply to Tax Credit projects underwritten for each program.
Section 3.9	Loan sizing ratios under 223(f) are provided, and these apply to Tax Credit projects underwritten for that program, unless adjusted for the FHA Housing Tax Credit Pilot Program in separate guidance available as of this writing.
Section 4.1	One stage application processing is permitted for all Tax Credit projects under all Sections of the Act because they are affordable by definition.
Section 5.28	Delayed submission of final plans is permitted for Tax Credit projects, assuming certain conditions are met.
Section 7.4	No market study, other than that which would be provided in the appraisal, is required for projects with 90% or more project based rental assistance.
Section 7.5	Requirements for market studies, applicable to all SOAs if required.
Section 7.9.I.	Estimating the land value of Tax Credit projects.
Section 7.14	Calculating operating deficits (for all Tax Credit projects.)
Section 7.16	Recognizing tax abatements in the underwriting, and waivers of standard underwriting rules for certain underwriting requirements for Tax Credit projects.
Section 7.17	Estimating the completed affordable project value for Tax Credit and other affordable properties.
Section 8.3	Identifying the principals in an LLC, LP or non-profit for purposes of mortgage credit review and limited review of tax

	credit equity syndicators and passive investors.
Section 8.4	Financial requirements of sponsors of affordable projects.
Section 8.7 & 8.8	Determining the mortgage amount and cash requirements; no escrowing of tax credit equity during construction; and Firm Commitment special conditions for deferred equity installments.
Section 8.9	Requirements for secondary financing from governmental lenders and for bridge loans used to fund equity during the construction period; use of HUD's form of Subordination Agreement instead of Note Rider.
Section 8.10	Requirements for grants and loans, and for various tax credits including the LIHTC, from governmental sources.
Section 8.11	Evaluating mortgage credit of nonprofit sponsors.
Section 8.13	Cash requirements for Tax Credit projects, including working capital and operating deficit escrows.
Section 8.14	Requirements for tax exempt bond financing.
Section 13.4	No cost certification required for tax credit project loans under 80% of cost.

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14.3 Historic and New Markets Tax Credits

Generally the LIHTC-related provisions of the Guide that are applicable to all LIHTC projects (within and outside of the Pilot Program) are also applicable to projects using Historic and New Markets tax credit equity. However these other tax credit programs are not housing based: The New Markets Tax Credits are administered by the CDFI Fund, while the Historic Tax Credits are administered by the National Park Service, the Internal Revenue Service, and the State Historic Preservation Offices. These programs are only occasionally used in FHA-insured projects, so no further policy is provided in this chapter. However, to the extent it is legally permissible and consistent with FHA's mortgage credit and underwriting standards, FHA will adapt its own practices to support the use of these other Tax Credit programs.

13 14.4 Subsidy Layering Review

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Subsidy Layering Review requirements have been eliminated for LIHTC projects with FHA-insured loans but no other sources of Federal subsidy, so most of HUD's mortgage insurance transactions are exempt. Regardless of the sources of funds, the lender and underwriter must **always** review the Sources and Uses statements for both mortgageable and non-mortgageable

1 funds, to ensure that costs are not being funded twice and that all costs funded from mortgage
2 proceeds are appropriate and necessary to complete the transaction.
3

4 In addition to the analysis of the Sources and Uses in the FHA loan underwriting, other public
5 funds combined with the FHA mortgage in a Tax Credit project may require a formal Subsidy
6 Layering Review. These public funds might include HOME Loans, secondary financing
7 provided from state or local sources, or capitalized debt supported by above-market, budget
8 based Section 8 rents. Criterion 11 on the *Supplement to Project Analysis* (HUD Form 92264-A)
9 is an optional worksheet to assist with loan sizing, including subsidy layering when applicable.

10 11 **14.5 Evidence of Tax Credit or Private Activity Bond Cap** 12 **Allocations**

13
14 The Firm Application for any LIHTC project should include evidence of 1) an LIHTC award in
15 the form of a 9% State Agency Allocation or in the case of 4% Tax Credits, an allocation of
16 private activity bond cap, or 2) in the case of Historic Credits or New Market Credits, an
17 equivalent form of verification from the appropriate agency. However, LIHTC allocation
18 timing varies state by state, and in some cases FHA applications must be submitted before final
19 allocations of tax credits can be secured. Accordingly other evidence is allowable, for example
20 state agency bond cap allocators' reassurances and written procedures stating that bond cap
21 remains available for the period in question, that an application has been submitted for the
22 project in question, that allocations are obtainable in the time available, etc., in the case of 4%
23 LIHTC allocations.
24

25 26 **14.6 Single Underwriter and Technical Reviews**

27
28 The Pilot and Rental Assistance Demonstration ("RAD") Programs have implemented the
29 "single underwriter model", which gives the HUD Underwriter responsibility and discretion to
30 determine what level of technical review is needed in several elements of the underwriting. The
31 assigned underwriter has discretion to waive technical reviews (other than Environmental site
32 visits and the signature on the 4128).
33

34 **14.7 Treatment of HAP Contract Renewals for Section 8 Assisted** 35 **Tax Credit Projects**

1 Rental assistance for LIHTC projects with Section 8 assistance (“Assisted Projects”) should
2 be in the form of a 20-year, Project Based Rental Assistance Section 8 Housing Assistance
3 Payment (HAP) contract or, in the case of a RAD/LIHTC Project, a 15-year Project Based
4 Voucher contract. The 20 year contract term is a requirement of FHA Productions’, not of
5 the Section 8 program.

6 Rent Comparability Studies (“RCSs”) form the basis of and must be completed well in
7 advance of any loan application, because they provide justification for rent increases and
8 are a requirement of the HAP Contract Renewal Request. The lender must review the RCS
9 as part of the underwriting process and take its conclusions into account when reviewing
10 the MAP appraisal. If the borrower commissions the RCS, the same firm cannot do the
11 appraisal. However if the lender commissions the RCS, the same firm can also do the
12 appraisal. The lender is expected to underwrite the loan using the rents from the RCS to
13 develop income and expense estimates (and/or the Section 8 budget prepared by the
14 borrower in the case of budget based rents) and to address any inconsistencies carefully in
15 the lender’s narrative. The HUD Underwriter will review the Section 8 HAP contract
16 request, RCS and lender’s underwriting narrative to verify that the rents requested by the
17 borrower in the HAP contract renewal request are supported by the RCS, and that the
18 lender’s underwriting is in line with both the RCS and the contract renewal request. At the
19 HUD Underwriter’s discretion the HUD appraiser may be asked to review an RCS to
20 determine its reasonableness. However if the PBCA appraiser has not undertaken a
21 detailed review of the RCS, the HUD appraiser must review the RCS to determine
22 reasonableness using Guidelines in Chapter 9 of the “Section 8 Renewal Policy”.

23
24 Close coordination among the assigned HUD Underwriter, the field office’s Office of Asset
25 Management and Portfolio Oversight (OAMPO) representative assigned to the project, and
26 if necessary, HUD HQS’ OAMPO staff is essential to ensure that a) the Section 8 HAP
27 contract renewal request and rent increase, if applicable, are approved in a timely fashion,
28 b) a prepayment approval is obtained if needed, and c) any other waivers are processed
29 and approved.

30 Section 8 HAP Renewal Requests and Rent Adjustment Requests must be requested from
31 the Performance Based Contract Administrator (PBCA) at least 60 days prior to the
32 submission of the LIHTC Firm Commitment application, and 120 days in advance is
33 preferable. The rents, expenses and debt service figures used in the lender’s underwriting
34 must be consistent with those in the Section 8 contract renewal request. Lenders should
35 assist borrowers to ensure that requested (and subsequently approved) rents are
36 consistent with the underwritten rents. Similarly, lenders’ requests for prepayment of an
37 FHA insured loan should be submitted to headquarters well before submission of the Firm
38 Application package to the HUD field office.

1 As noted above, the processing of Section 8 subsidized Pilot Program projects requires
2 owners to execute a 20 year HAP contract, except for Mark-to-Market (M2M) projects that
3 received exception rents. RAD projects are eligible for the Pilot as long as at least 90% of
4 their units are Section 8 assisted, and they have new 15-year Project Based Voucher
5 contracts. In many cases this will require HUD to authorize the Owner to terminate the
6 existing HAP contract for the purposes of executing a new 20 year HAP contract. If the
7 project is operating under a multi-year term contract, the Owner and HUD must, by mutual
8 agreement, terminate the existing HAP contract and execute a Renewal Contract with a
9 new 20 year term, subject to the availability of appropriations. The Owner must also agree
10 to execute an Exhibit to the Section 8 HAP contract agreeing to renew the HAP contract
11 again at the end of the 20-year term for at least the number of years remaining on the
12 contract in place at the time of the early termination. The Preservation Exhibit must also
13 be executed.

14
15 As part of the contract renewal (for non-M2M projects), the borrower must request from
16 OAMPO any desired rent increase, whether budget-based or market-based, prior to the
17 submission of the application for processing under the Pilot. As described below, the MAP
18 Lender must work with the borrower to address the rent request as part of the loan
19 underwriting prior to submission.

20
21 An exception to the HAP Renewal Request requirement may be made if the borrower has
22 renewed the project's contract for a 20 year term within the 12 month period prior to the
23 anticipated closing date of the new FHA-insured loan. In such cases the lender is to submit
24 a copy of the borrower's HAP Contract Renewal Request that lists any requested rent
25 adjustment (which must be supported by either a Rent Comparability Study, a budget, or
26 both, in accordance with OAMPO requirements).

27 Lenders are advised that if the borrower requests a market-based rent increase at "post
28 rehab" market rent levels to support the new insured loan at initial closing, under the
29 221(d)(4) program a Section 8 escrow will be required to fund the difference between the
30 existing rents and the post-rehabilitation rents during the construction period. Lenders
31 should include this escrow in their underwriting. Alternatively under the 223(f) program a
32 waiver of the prohibition against post rehab rents during construction can be obtained.
33 Borrowers and their lenders should refer to the Section 8 Renewal Policy for details on
34 post-rehab rents.

35 Submission of copies of the HAP Contract Renewal Request by the lender as part of the
36 LIHTC project application is also critical: It demonstrates that the rents requested by the
37 borrower match the rents used in the underwriting submitted by the lender, and it serves
38 as evidence that the borrower has in fact submitted the request for the contract

1 renewal/rent increase. If the borrower is submitting a budget-based rent request, the
2 lender must coordinate closely with the borrower to arrive at a preliminary debt service
3 figure for the new loan that the borrower will include in the proposed budget to submit to
4 HUD and the PBCA. The final debt service figure is subject to change during the final
5 underwriting process, so this may need to be amended on the HAP contract request later.
6 However it is critical that the income, expenses and debt service figures listed on the
7 borrower's request match the figures in the lender's underwriting. Specific forms and
8 documentation for inclusion in the Firm Approval Application include the following:

9 A. Project Rent Comparability Study prepared for the Section 8 contract renewal must be
10 submitted with the LIHTC Firm Approval Application.

11 B. MAP-compliant appraisal and HUD forms 92264, 92273 and 92274 are required.
12 However, appraiser may opt to use the 92273 used in the Rent Comparability Study or
13 another format and may use Form HUD 92274 or an alternative format acceptable to
14 the lender and the HUD Underwriter for expenses.

15 C. The information supplied in the RCS and required by OAMPO for the rent
16 increase/contract renewal request is the same information required for the Firm
17 Application on forms 92273 and 92274, so there is no need for the lender or the
18 lender's appraiser to recreate the information on a form for the application. The HUD
19 Underwriter may also consult iREMS for historic rental income and project expense
20 information if this information is helpful to verify the income and expenses used in the
21 underwriting. HUD staff will not perform a review of the MAP appraisal for Assisted
22 Housing projects: This review is delegated to the project's approved MAP lender.
23
24

25
26 Note regarding RAD/FHA/LIHTC Projects: HUD has issued separate guidance for Rental
27 Assistance Demonstration projects with regard to the underwriting of RAD transactions
28 with FHA-insured loans and LIHTC.

30 **14.8 Application/Submission Requirements**

31
32 The following describes a few important application requirements for all Tax Credit Projects,
33 that differ from those described in other sections of the MAP Guide for projects without Tax
34 Credits. Other application documents specific to the Pilot Program are listed in a separate Tax
35 Credit Project Application Exhibits Checklist.
36

- 1 A. Lender’s Application Form. The Tax Credit Program Pilot Lenders’ Narrative template is
2 available on HUD’s Tax Credit Pilot website at:
3 http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/map/maphome/taxc
4 [redit](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/map/maphome/taxc). It can be used for all Tax Credit Projects.
5
- 6 B. Data Submission. A separate version of the “Wheelbarrow”, set up to provide specialized
7 information with respect to sources and uses of funds, draw schedules and other matters
8 essential to analysis of LIHTC projects, must be submitted for all Tax Credit projects in
9 place of the standard Wheelbarrow. It is available on HUD’s Tax Credit Pilot website at:
10 http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/map/maphome/taxc
11 [redit](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/map/maphome/taxc). This Wheelbarrow may also be used for all Tax Credit projects.
12 Other standard documents will be those used for a given project’s SOA program.
13
14

15 **14.9 Architecture and Engineering**

- 16
- 17 A. Tax Credit refinancing and substantial rehab projects must conform to all current PCNA
18 requirements.
19
- 20 B. The ALTA Survey submission may be waived for Tax Credit transactions involving the
21 refinance of a project with an existing FHA-insured mortgage, if the new FHA lender
22 submits a statement certifying that there have been no material changes or additions to the
23 structure or property boundaries since the closing of the original loan. Accordingly HUD
24 may accept an existing survey for such projects rather than requiring a new survey document.
25
- 26 C. Plans and Specs may be delivered after Firm Commitment but prior to closing, so long as
27 sufficient time is allowed for review prior to closing.

28
29 Other Documents: A Specialized Checklist for Application Submissions on Tax Credit Projects
30 is included in Appendix ___ and available at the following link:
31 http://portal.hud.gov/hudportal/documents/huddoc?id=Appendix_D_Checklist.pdf
32
33
34
35
36

1 project. HUD will rely on other information with respect to the GC's experience described
2 in a resume that must include 1) a discussion of relevant multifamily experience, 2) a
3 schedule of jobs in progress, 3) the Form 2328, 4) the IOI certification, and 5) HUD's
4 response to processing of the 2013-SUPP "4-magic-questions." HUD or the lender may
5 determine that greater detail is warranted, for example, in the case of a relatively
6 inexperienced or undercapitalized borrower and/or a high cost rehab.
7

8 **14.11 Identities of Interest in Tax Credit Transactions**

- 9
- 10 A. Identity of Interest ("IOI") between the Owner/Developer and the General Contractor
11 ("GC"). An IOI between the GC and the owner is allowed and it does not require a waiver,
12 but it must be disclosed in the application and may affect the fee structure. Including both
13 GC Profit and a Developer Fee when there is an IOI relationship between the
14 developer/owner and the general contractor also causes concern with respect to overpayment.
15 HUD will generally rely on the policies of State tax credit allocation agencies that often scale
16 fees down to lower limits when a given party or set of related parties is receiving both the
17 Developer Fee and the GC Profit, since combined these fees may be redundant and
18 excessive. HUD's Underwriters will evaluate the fees and profits and reduce them if
19 necessary.
20
- 21 B. Identity of Interest between the Lender and Syndicator. FHA allows an exception to its
22 prohibition on identities of interest in certain cases, allowing MAP Lenders to retain
23 interests of up to 25% in the tax credit equity of projects for which they are the FHA lender
24 (with no limit on the number of projects.) In addition FHA will, for certain supervised or
25 publicly held MAP Lenders, consider this exception for up to 10 transactions per calendar
26 year in which the MAP Lender may hold up to 100% of the ownership in the LIHTC limited
27 partner or equivalent investor member in an LLC. **See Section 2.6.** These transactions are
28 "counted" at the time of firm commitment application.
29
- 30 C. IOI Transfers for Non-Profits. Nonprofit owners of currently insured or HUD-held
31 properties may syndicate LIHTC properties and form new partnerships subject to HUD's
32 Transfer of Physical Asset ("TPA") policies. (See Housing Notice 2011-31.)
33

34 **14.12 Calculation of Mortgage Amounts for Tax Credit Projects**

- 35
- 36 A. Section 223(f) applications for Tax Credit projects that involve transfers of ownership may

1 be treated as acquisitions for purposes of sizing the mortgage: Lenders may use either
2 Criterion 7 or 10.

3
4 B. Underwriting Tax Abatements. If a purchase or refinancing transaction includes LIHTC
5 equity, the underwritten NOI may recognize tax abatements even if they run with the
6 sponsorship (mortgagor) entity and not with the land. Procedures in **Section 7.18** must be
7 followed.

8
9 C. Substantial Rehab Contingency. Generally, unspent contingency funds in an FHA-Insured
10 loan project must go into a Reserve for Replacement Account (“R4R”) or pay down the
11 mortgage. One exception to this rule applies however, for Low Income Housing Tax Credit
12 properties with affordability restrictions that 1) meet the Risk Mitigation ML/HN standards
13 **AND** 2) have mortgages that are not sized with the use of the cost criterion. In such cases,
14 HUD allows contingency funds included in the FHA mortgageable cost basis, but not needed
15 for repairs, appropriate betterments, or deposits to R4R, to be used to pay a developer’s fee
16 or any other reasonable reimbursement item. Such funds should not be released until the later
17 of Final Endorsement or 6 months of sustaining (breakeven) occupancy. Release of funds
18 requires Field Office approval of project repairs, performance, and demonstrated compliance
19 with all terms of the Tax Credit Program or other requirements of the applicable business
20 agreements.

21 22 **14.13 Developer Fees and GC Profit**

23
24 A. Developer fees will be treated as mortgageable costs so long as they are 1) in amounts
25 approved by the project’s LIHTC allocation agency, but not to exceed 15% of the total
26 development cost of the project, excluding the developer fee, and 2) scheduled for payment
27 in amounts and at times agreed upon with the syndicator.

28
29 For FHA-insured loans limited to 80% of value, the loan to cost ratio provides a safe harbor
30 and limits risk, so proceeds may be used for any purpose including payment of development
31 fees higher than those described above. However when LTV is increased to the Criterion 10
32 limits (87% for Section 8 LIHTC projects and 85% for unassisted LIHTC projects), payment
33 of developer fees with FHA mortgage proceeds is limited to the amount approved as
34 described above to the extent supported by the mortgage and consistent with all other
35 allocating agency rules and the partnership or operating agreement. Developer fees cannot
36 be claimed for projects for which BSPRA or SPRA is claimed.

1
2 No distinction is made by HUD between developer fees paid with equity or debt sources
3 drawn down prior to completion, and deferred developer fees paid from operations after
4 completion.

5
6 B. Neither BSPRA nor SPRA may be claimed when developers' fees are included in the project
7 budget. Both BSPRA and SPRA may be treated as mortgageable costs, but they are not a
8 source of cash.

9
10 C. Relationship of Developer Fee to General Contractor Profit and Determination of Fees in
11 Cases with an IOI Relationship between Contractor and Owner/Developer. No blanket
12 restriction has been imposed on the amount of General Contractor Profit, though it must be
13 reasonable based on the market and the scope of work. Claiming both a GC profit and a
14 developer fee when there is an IOI relationship between the two can result in excessive
15 compensation however. HUD generally relies on the policies of the State tax credit
16 allocation agencies, which often scale fees down to lower limits when a single party or two
17 related parties are receiving both the Developer Fee and the GC Profit. HUD's Underwriters
18 will evaluate the fees and profits for each project and reduce them if they are determined to
19 be excessive, considering the scope of the project and the amount of the proposed fees.

20
21 D. Structuring of Deferred Developer Fee as Secondary Debt. Deferred developer fees may be
22 treated as either secondary debt or equity. If treated as debt, the obligation must be
23 documented in a promissory note. That note, in combination with any other secondary debt,
24 cannot require payments exceeding 75% of surplus cash. The debt must also be subject to
25 automatic re-subordination and cannot contain any foreclosure provisions. It may be secured
26 with the project as long as total subordinate debt does not exceed 100% of total project costs,
27 as determined by a comprehensive analysis of sources and uses of funds. Alternatively if the
28 deferred developer fee is an obligation of one or more of the principals of the ownership
29 entity and will not encumber the project or become an obligation of the ownership entity, it is
30 considered equity, not debt. Accordingly it will not be considered secondary financing.

31
32 E. Payoff of Deferred Developer Fees in a Subsequent Transaction. When the FHA
33 mortgage serves as a take-out source on a recently completed new construction or
34 rehabilitation project, a deferred developer fee note from the most recent transaction (i.e. the
35 construction closing) will be treated as originally structured. If the note is an obligation of

1 one or more of the principals as described above, the deferred fee will be treated as equity,
2 the cost of paying it off would not be mortgageable and the liability would have to be satisfied
3 so as not to remain in place after the FHA loan closing. Alternatively if the note was
4 structured as a debt of the ownership entity or project it may be recognized and paid off in
5 the same manner as other debt, or assumed by the purchaser to remain in place after the
6 refinancing. Because developer fees must be paid off for tax reasons within ten to twelve
7 years in order to be treated as part of a project's eligible basis for Tax Credit purposes, the
8 notes are not likely to be problematic in later refinancings such as those often done after year
9 15. Generally a deferred developer fee note will not be included in mortgageable cost basis,
10 unless it is paid off through cash out in an 80% LTV transaction.

11 12 **14.14 Structuring of Secondary Debt in Tax Credit Transactions** 13

14 A. LTV Ratio. For transactions that do not have Low Income Housing Tax Credits, Section
15 223(f) limits the combination of FHA insured and secondary financing to a loan to value
16 limit of 92.5% (except when the debt source is a public entity). For tax credit projects
17 however, the debt limit can restrict property basis and tax credit amounts. Accordingly,
18 HUD will not impose a loan to value limit on the secondary financing, regardless of the
19 source, subject to the following conditions on the secondary debt:

- 20
- 21 1) Payments are allowed only from surplus cash, if available;
 - 22
 - 23 2) The total combined secondary debt does not exceed the limit of 100% of total project
24 costs as confirmed by the HUD Underwriter's analysis of a comprehensive Sources and
25 Uses statement;
 - 26
 - 27 3) The secondary debt can reasonably be expected to be paid off over its term with 75% of
28 the project's operating cash flow;
 - 29
 - 30 4) The debt is documented in a promissory note with simple interest. Waivers to allow
31 compounding of interest may be approved at HUD's discretion if the lender's analysis
32 demonstrates that project cash flow will be sufficient to avoid accruals of interest that
33 would undermine the long term financial and physical integrity of the project, and all
34 other risks have been adequately mitigated; and
 - 35
 - 36 5) The debt is subject to automatic re-subordination in any refinancing of the first mortgage.

- 1 B. Secondary Debt Payments from Cash Flow. The promissory note(s) cannot require more
2 than 75% of cash flow be paid to secondary debt. This limit applies to all secondary debt, to
3 ensure that at least 25% of cash flow remains as an incentive to the owner. Owners are not,
4 however, prohibited from making additional payments on the loan out of cash flow or from
5 other sources.
- 6 C. Bridge Loans. Bridge loans are not treated as other secondary financing, and are described in
7 detail below in Part 14.16.
- 8
- 9 D. Publicly Funded Loans. Loans funded with HOME Funds or other federal, state or local
10 public sources, Affordable Housing Program (FHLB) Grants, and other public sources are
11 often granted or lent directly to the borrower (or to the GP or sponsor of the borrower, who
12 will then loan it to HUD's borrower.) All such sources will be treated as public secondary
13 financing sources, and as such need not be included in the calculation of the 100% of total
14 project cost limit applied to private secondary debt. However, none of these sources may be
15 substituted for Tax Credit Equity required by the pay-in schedule provided below.
- 16
- 17 E. Deferred Developer Fees. These fees may be converted to notes secured by the property and
18 paid from surplus cash, but then they must be included as debt in the 100% of total project
19 cost calculation. Deferred developer fees may also be treated as equity, in which case they
20 are not secured with the property and may be paid only through surplus cash. For further
21 detail on developer fees in Tax Credit Projects, see Section 14.13.

22 **14.15 Tax Credit Equity Pay-In Schedule**

23
24
25
26 FHA requires minimum Tax Credit equity contributions according to the following, fixed pay-in
27 schedule for all LIHTC transactions.² It is to be added as a special condition to the Firm
28 Commitment for all Tax Credit Projects, and used as a method of checking proposed
29 disbursement schedules. Waivers of the first 20% equity pay-in will not be considered.
30

² This schedule does not apply to equity derived from New Market or Historic tax credits.

Benchmarks for Equity Installments	Minimum Equity Installment (% of Total Equity)³	Cumulative Equity Paid In⁴
On Or Before Closing	20%	20%
At 65% Construction Completion	30%	50%
At Stabilization ⁵	45%	95%
Delivery of IRS Form 8609 to Investors, or within one year of the Delivery Date	5%	100%

Equity investors may fund all or part of the required equity investments defined above with bridge loan proceeds as long as the bridge loans meet the requirements described in Section 14.16 below. However investors may not substitute any grant or loan funds, other than funds in the form of Bridge Loans as described in Part 14.16 below, for the equity payments described in the chart above. The term “equity” in this section also excludes Deferred Developer Fees.

14.16 Bridge Loans in Tax Credit Projects

Bridge loans may be used by Tax Credit investors to defer the pay-in of equity during a project’s development and stabilization phases, thereby increasing the return on equity. The bridge loan must remain the obligation of one or more of the investors or other upper tier partners to the ownership entity (i.e. the limited or general partners), and not the project ownership entity or single-asset mortgagor itself. In addition the following conditions must be met:

- A. Bridge loans may not be secured by a lien on the real estate, although they may be secured with a pledge of Tax Credits and/or of limited partners’ or investor members’ interests in the project’s ownership entity;
- B. The borrower may be the project sponsor, but not the owner of the property/FHA Mortgagor;
- C. The obligation must be evidenced by a promissory note;

³ Additional equity is acceptable at each benchmark date shown, as well as at other interim dates at the investors’ discretion. However the amounts shown in the “Cumulative Equity Pay-In Column” are the minimums required at any given benchmark date listed in the chart.

⁴ All percentages used in this chart represent percentages of total net equity (i.e. not equity for mortgageable costs) going into the project as tax credit proceeds.

⁵ Stabilization is the point at which the projects operations have achieved a minimum debt service coverage ratio of 1.0:1 for 6 consecutive months.

- 1
2 D. The term of the note may last through the construction or rehabilitation period but must be
3 paid in full no later than one year after the initial issuance of the 8609 Forms to the equity
4 investors; and
5
6 E. At Firm Application, the lender must submit a term sheet describing the key terms of the
7 bridge loan, as well as a certification that a) the loan will be secured only by a pledge of
8 partnership interests or tax credit benefits and not by the project, and b) that the bridge lender
9 will have no claim against the mortgaged property, mortgage proceeds, any reserves or
10 deposits, or against the rents or other income from the property for repayment of the bridge
11 loan.
12
13

14 **14.17 Syndicator and Investor Fees from Operations**

15
16 Tax Credit projects often involve annual asset management related fees paid to the syndicator or
17 an investor representative. HUD's Office of Asset Management and Portfolio Oversight allows
18 usual and customary fees and expenses for operating a Tax Credit project, including payment of
19 a syndicator's and/or investor's asset management fee, state allocation agency compliance and
20 asset monitoring fees, and mandatory interest payments of up to one percent on subordinate debt
21 provided by a government lender to be paid from the operating budget. Deferred developer fees,
22 along with interest accrued at the Applicable Federal Rate for up to 12 years, may be included as
23 an operating budget line item but may only be paid from surplus cash after the FHA-required
24 reserves and first mortgage debt service are met. These fees are identified in the distributions
25 "waterfall" of payments in the project's partnership agreement (or operating agreement, in the
26 case of a Limited Liability Company.) If the expenses described above are included in the
27 operating budget however, the loan must be sized accordingly by the lender, and the chosen
28 treatment of the expenses must be documented in the closing documents. HUD generally
29 requires that at least 25% of surplus cash remains available as an owner incentive, though the
30 remaining 75% may be obligated to payment of secondary debt.
31

32 Mark to Market Transactions: Owners are allowed to receive an Incentive Performance Fee
33 (IPF), and this is paid before the 25%/75% split is calculated. Thus the IPF is paid first, and is in
34 addition to the owner's 25% of remaining funds. Mark to Market also obligates the owner to use
35 the full 75% to pay down the program's secondary M2M loans. Accordingly in M2M
36 transactions, the payment of syndicator's and investors' fees must be limited to the 25% that is
37 not committed for loan repayment.

14.18 Vacancy Rates

Vacancy rates used for loan sizing purposes (and generally as a guide for appraisers) are herein revised for all projects, to reflect differences in project types, as follows.

<i>Minimum Vacancy Rate</i>	<i>Property Type</i>
3%	<ul style="list-style-type: none"> • HUD-assisted property with HAP contract covering 90% or more of the units; or • In-place rehab with 90% or greater occupancy and 90% or more of the units LIHTC-restricted units with attainable tax credit rents at least 10% below comparable unit market rents (i.e. "...a 10% discount to market.").
5%	<ul style="list-style-type: none"> • 80% or more of the units are LIHTC-restricted units with at least a 10% discount to market.
7%	<ul style="list-style-type: none"> • 100% of the units are LIHTC restricted, without a 10% discount to market; or • More than 20% of the units are Market Rate.

14.19 Other Matters

- A. The market study, appraisal and underwriting for all Tax Credit projects must address the relationship between the Tax Credit ceiling rents, the attainable rents, any subsidy contract rents and other terms, and true market rents. Any disparities among these rents, and their related risks, must also be addressed.

- B. HERA’s Exception to the Tax Credit Program’s 10 Year Holding Period. HERA provides for an exception to the LIHTC’s ten year holding period requirement for certain federally assisted buildings, specifically those that are 221(d)(3 or 4) or 236-insured. Because the HERA language refers to the two specific programs noted above as well as to "...any other program administered by the Department of Housing and Urban Development..." the waiver should apply to all FHA-insured tax credit projects. HUD does not render tax advice however so owners should seek tax counsel with respect to this interpretation.

- 1
2 C. Bond financed projects in New York City. Section 42 of the IRS Code provides that for
3 projects located in New York City, the “40-60” test for determining whether a project
4 qualifies as a low-income project is replaced by a “25-60” test. Thus the affordability
5 requirement is reduced from 40% to 25% of the units to be set aside at 60% of area median
6 income. HUD will consider this exception to the set-aside on a case by case basis, when the
7 lender’s application demonstrates that the less restrictive NYC rents will still provide for
8 significant affordability in the local market.
9
- 10 D. Lien Priority. HUD requires the FHA mortgage lien to be in first position, although the
11 Department recognizes that in some instances it may facilitate a transaction if a Land Use
12 Restriction Agreement (LURA) is allowed to be recorded prior to the FHA mortgage. On a
13 case-by-case basis HUD may approve non-monetary use restrictions that run with the land
14 and thus may be superior in priority to HUD’s first mortgage position. In these cases the
15 Lender must demonstrate and the HUD Underwriter must verify sufficient financial strength
16 to mitigate the risk of a negative impact on the marketability of the project in the event of a
17 foreclosure or loan sale.
18
- 19 E. Tax Credit Regulatory Agreements. In Tax Credit projects, certain IRS Section 42
20 obligations must be allowed to continue post-default. Generally, however, for the Tax Credit
21 LURA, or when public secondary financing with regulatory agreements required used, HUD
22 requires the use of the standardized rider, indicating that in case of conflicts between a
23 LURA and FHA “program obligations,” FHA requirements take precedence. Neither this
24 provision nor the use of the rider itself should be waived. Instead, staff must identify the
25 point of conflict and consult with OGC. Alterations of the rider that are once approved can
26 then be used as the template for that jurisdiction. It is the lender’s responsibility to draw
27 attention to potential conflicts between FHA requirements and the LURAs or other restrictive
28 covenants as early as possible (i.e., during Concept Meetings) and no later than with Firm
29 Commitment application submission, not at the closing table.
30
- 31 F. Mortgagee Letter 2013-31: Extension of Temporary Authority for Multifamily Hubs to
32 Process Waiver Requests Pertaining to the Three-Year Rule for Section 223(f) Refinancing
33 or Acquisition of Affordable Multifamily Housing. This rule enabled owners to obtain lower
34 rate FHA-insured mortgages to pay off construction financing prior to the end of the existing
35 three year rule prohibition. The current guidance has since expired (September 19, 2014) and
36 further extensions are not anticipated but an exception has been made for Tax Credit Pilot
37 projects that received building permits prior to the 2014 expiration of the notice.

1
2 G. Tax Exempt Bonds/Take out by FHA Insured Permanent Debt. Many tax credit projects are
3 financed with the “4%” tax credits allocated in conjunction with private activity bond volume cap
4 (rather than the “9%” tax credits allocated by State Agencies). Currently, taxable GNMA yields
5 and the resulting rates on FHA multifamily loans are lower than tax exempt bond and municipal
6 bond-backed multifamily loan rates. The investment banks have developed an approach
7 combining taxable GNMAs with Tax Exempt Bonds and 4% LIHTC to achieve these lower rates.
8 The structure establishes two escrows, allowing bond proceeds to be retired immediately by
9 warehouse funds, which in turn are reimbursed with GNMA-backed FHA proceeds used to fund
10 the draws. This enables the borrower to avoid higher rate construction loan proceeds backed by
11 tax exempt bonds alone, while taking advantage of the 4% tax credit equity.

12
13 This bond financing structure is acceptable to HUD as long as OGC reviews the transaction for
14 statutory or programmatic issues that may come up in the context of specific transaction
15 documents and agreements, to ensure loan proceeds are used for to construct the project or
16 improvements. Accordingly OGC staff must be involved early in the process to ensure these
17 issues are addressed early and do not slow down the transaction’s processing. FHA loan proceeds
18 cannot be used to serve as collateral for the bonds, and OGC requires lenders to sign the “Lender
19 Certification for Tax Exempt Bond and 4% Low Income Housing Tax Credit Transactions” for
20 such financings.

21
22 H. Refinancing of M2M Properties. HUD’s Office of Recapitalization, along with the field
23 offices’ Asset management staff, are responsible for reviewing any transactions that have
24 been through an M2M restructuring. Those transactions require a waiver of the “due on
25 sale...” clause in all subordinate notes originated in the restructuring. Current guidance is in
26 Notice H 2012-10, and it explains when the field offices can process the waivers, and when
27 HQs must do it. In complex Tax Credit transactions requiring subordination of M2M debt,
28 the owner or lender must request the waiver as early as possible to avoid delays, especially in
29 the case of Tax Credit Pilot transactions. FHA Production staff may also be involved to
30 ensure that the Recapitalization office’s conclusions are consistent with the underwriting of
31 the project.

32 33 **14.20 FHA Tax Credit Pilot Program Expansion**

34
35 Expansion of the FHA Tax Credit Pilot Program to include new construction and substantial
36 rehabilitation projects is forthcoming in future guidance.

Chapter 15 Quality Assurance Enforcement Actions

15.1 Oversight of Map Lenders

By permitting a MAP Lender to prepare much of the documentation for a loan submission for mortgage insurance, HUD places confidence in the lender's integrity and competence. HUD and MAP Lenders have a mutual interest in ensuring consistent lender competence and compliance with the MAP Guide and other relevant guidance and handbooks. If in the process of performing this work, the lender places HUD at un-due risk, HUD will issue a Warning Letter or sanction the lender.

Every HUD multifamily employee plays an important role in the MAP Quality Assurance (QA) effort. This Chapter provides QA guidance to Program Centers, Hubs, and the Office of Multifamily Production (OMP) Headquarters, including the Office of Counterparty Risk Management (CRM). Such quality assurance tools are: i) Warning Letters; ii) Probation; iii) Suspension; iv) Termination; v) Limited Denial of Participation (LDP); and vi) referral to the Mortgagee Review Board or the Office of Inspector General. An LDP is a sanction applied to participants in loan transactions other than FHA-insured lenders under procedures set forth in 24 CFR § 2424 Subpart J. The purpose and authority of the Mortgagee Review Board is set forth in 24 CFR Part 25. This Chapter of the MAP Guide implements 24 CFR part 200, Subpart Y.

15.2 Authority to Issue MAP Sanctions

A. General.

1. At any time, a Hub/PC Director, the Director of the Office of Multifamily Housing Production (OMP) Headquarters, or the Director of Asset Management and Counterparty Oversight Division (AMCOD) may initiate discussions with a MAP Lender regarding any concerns HUD has with respect to any of the lender's actions or personnel, or any changes the lender should make in using its MAP authority.
2. If there are concerns about the lender's underwriting and/or construction loan administration, a Hub/PC Director, the Director of OMP or the Director of AMCOD may take certain actions detailed below.

- 1 3. Every HUD multifamily employee must refer any possible instances of fraud,
2 material misrepresentation or other criminal violations to the Office of the Inspector
3 General.
- 4 B. A Program Center Director may:
- 5 1. Recommend to the Hub Director that s/he recommend to the Director of AMCOD the
6 Probation, Suspension or Termination of a MAP Lender.
- 7 2. Initiate the issuance of a LDP of an individual or a firm involved in a “covered
8 transaction” as defined in 2 CFR 2424.220.
- 9 C. A Hub Director may:
- 10 1. Recommend to the Director of OMP or AMCOD the issuance of an LDP to an
11 individual or firm involved in a “covered transaction” as defined in 2 CFR 2424.220.
- 12 2. Recommend to the Director of OMP or AMCOD that the MAP Lender be referred to
13 the MAP Lender Review Board for possible Probation, Suspension or Termination.
- 14 D. The Director of OMP or AMCOD may:
- 15 1. Refer an individual or a firm involved in a “covered transaction,” as defined in 2 CFR
16 2424.220 to Headquarters’ Deputy Assistant Secretary (DAS) for Multifamily
17 Housing for imposition of an LDP, which may be imposed nationwide or on a more
18 geographically restricted basis.
- 19 2. Refer the MAP Lender to the MAP Lender Review Board for possible Probation,
20 Suspension or Termination.
- 21 3. Issue a Warning letter.
- 22 E. The DAS for the Office of Multifamily Housing Programs may:
- 23 1. Issue a Warning Letter.
- 24 2. Refer the MAP Lender to the MAP Lender Review Board.
- 25 3. Refer the MAP Lender to the Office of Inspector General.
- 26 F. All recommendations authorized in Sections 15.2B through E shall be in writing, and
27 shall state the reasons for the recommendations and the supporting facts.
28 Recommendations for an enforcement action shall be transmitted to the next higher level
29 of review, as set forth above, together with copies of all supporting documents.

30

15.3 Basis for issuing a Warning Letter or Sanctioning a MAP Lender

A MAP Lender's improper, inaccurate or inadequate underwriting and construction loan administration may lead to a Warning Letter or other sanction from HUD. Examples include, **but are not limited to**, the following:

A. Minor offenses that may be the basis for a Warning Letter include:

1. Failure to provide required exhibits or the submission of incomplete or inaccurate exhibits. Although the MAP Lender will be permitted to correct minor errors or provide additional information, substantial inaccuracies or lack of significant information will result in return of the application and retention of any fees collected.
2. Repeated failure to complete processing to Firm Commitment unrelated to the project underwriting analysis.
3. Preparation of an underwriting Narrative Summary that is not supported by the appropriate documentation and analysis.
4. Failure to notify the HUD processing office promptly of changes in the mortgage loan application for a Firm Commitment that has been submitted, such as changes in rents, numbers of units or gross project area.
5. Failure to meet MAP closing requirements or construction loan administration requirements.
6. Business practices that do not conform to those generally adopted by prudent lenders or that show irresponsibility.
7. Failure to cooperate with an AMCOD review.

B. Serious offenses that might be the basis for a Warning Letter, Probation, Suspension, or Termination include:

1. Receipt of multiple Warning Letters over any one-year period. In determining which sanctions to pursue as a result of prior warning letters, HUD will consider the circumstances surrounding those warning letters and any corrective actions undertaken by the lender.
2. Fraud or material misrepresentation in the lender's participation in FHA multifamily programs.
3. Lender collusion with or influence upon third party contractors to modify reports prepared by the contractor that affect the contractor's independent evaluation.

- 1 4. A violation of MAP procedures by a third party contractor, which the MAP Lender
2 knew, or should have known, was occurring and which, if performed by the MAP
3 Lender itself, would constitute a ground for a sanction under this chapter.
- 4 5. Evidence that a lender's improper, inadequate or inaccurate underwriting was a cause
5 for assignment of an insured mortgage.
- 6 6. Identity-of-interest violations under Section 2.6 of this Guide.
- 7 7. Payment by or receipt of a payment by a MAP Lender of any kickback or other
8 consideration, directly or indirectly from the sponsor or from any other participant in
9 the transaction, which would affect the lender's independent evaluation, or represent
10 a conflict of interest, in connection with any insured mortgage transaction.
- 11 8. Failure to comply with any agreement, certification, undertaking, or condition of approval
12 listed in a MAP Lender's application for approval.
- 13 9. Noncompliance with any requirement or directive of the Director of OMP or
14 AMCOD.
- 15 10. Violation of the requirements of any contract with HUD or violation of the
16 requirements in any statute, regulation, handbook, notice, mortgagee letter, or other
17 written rule or instruction including the MAP Guide as interpreted by answers to
18 Frequently Asked Questions (FAQ's) that are posted on the MAP website.
- 19 11. Submission of false information or a false certification to HUD in connection with
20 any MAP mortgage transaction.
- 21 12. Failure of a MAP Lender to respond in a timely manner to inquiries from the
22 Director, OMP or AMCOD in accordance with this Chapter.
- 23 13. Indictment or conviction of a MAP Lender or any of its officers, directors, principals or
24 employees for an offense that reflects on the responsibility, integrity or ability of the lender
25 to participate in MAP.
- 26 14. Employing or retaining an officer, partner, director or principal at the time when the
27 person was suspended, debarred, ineligible or subject to a LDP, or otherwise
28 prohibited from participation in HUD programs, when the MAP Lender knew or
29 should have known of the prohibition.
- 30 15. Employing or retaining an employee who is not an officer, partner, director or
31 principal, and who is or will be working on HUD-FHA program matters, at a time
32 when that person was suspended, debarred, ineligible, or subject to a LDP or
33 otherwise prohibited from participation in HUD programs, when the MAP Lender
34 knew or should have known of the prohibition.
- 35 16. Failure to cooperate with an audit or investigation by the HUD Office of Inspector

- 1 General or an inquiry by HUD into the conduct of the MAP Lender.
2 17. Failure to fund insured mortgage loans or any misuse of mortgage loan proceeds.
3
4 C. The issuance of a Warning Letter is not a prerequisite to the Probation, Suspension or
5 Termination of a lender's MAP privileges.

6 **15.4 Administrative Record**

7
8 When any final action is taken against a MAP Lender, an administrative record must be prepared which
9 includes all materials that may have influenced the decision and not merely those relied upon in the final
10 decision. Although not intended to be an exhaustive listing, examples of material that should be included
11 in the record are:

- 12 • Correspondence between the lender and HUD or the lender and any third party
13 contractors;
- 14 • E-mails, if relied on in the decision process;
- 15 • Fax's including the FAX cover sheet and the FAX confirmation sheet;
- 16 • Application and underwriting submissions;
- 17 • Copies of appropriate sections of notices, guide books including FAQ's posted on the
18 Multifamily web site, handbooks, regulations and statutes;
- 19 • Notes from meetings and telephone conversations; and
- 20 • Work product and recommendations from subordinates.

21 The term "final action" includes issuance of a Warning Letter but does not include any referral,
22 recommendation for action, or presentation to the Director of OMP or AMCOD. In matters before the
23 Director of OMP or AMCOD, the administrative record ordinarily will consist of the referral and the
24 materials accompanying the referral, any written materials submitted by the lender and any written
25 materials submitted by the Director of OMP or AMCOD in response to those materials, the transcript of
26 the informal meeting when that transcript is a part of the record, and the final decision of the Director.

27

1 *Note: Intra-agency memoranda and other such records should be included, but will not be released if*
2 *privileged. The administrative record in its final form as described in this Section relates to and*
3 *supports HUD's final action and is not to be released to any person outside of HUD until it has been*
4 *reviewed by the Office of General Counsel. All evidentiary material supporting any recommendation*
5 *to the MAP Lender Review Board must be delivered to the lender as provided in Section 15.13.A and*
6 *must be included in the administrative record.*

7 **15.5 Warning Letters**

- 8
- 9 A. The Director of OMP, AMCOD and the DAS may issue a Warning Letter to a MAP
10 Lender.
- 11 B. The Warning Letter:
- 12 1. May require a meeting in the official's office with principal owners of, and/or
13 Officers of the MAP Lender to discuss the problem(s) and possible corrective
14 action(s).
- 15 2. Shall specify the violation(s) for which the Warning Letter is issued. If the Warning
16 Letter explains or interprets a section of the MAP Guide, the text of the letter (after
17 deleting all information that might identify the MAP Lender concerned) shall be
18 posted on the Multifamily MAP web site as a FAQ.
- 19 3. Direct the taking of a corrective action.
- 20 C. The Warning Letter does not suspend a lender's MAP privileges but may impose a higher level of
21 review of the lender's underwriting by the Hub/PC and/or Headquarters.
- 22
- 23 D. The Warning Letter must clearly state that it is a Warning Letter issued pursuant to this Chapter.
24 The letter will be mailed to:
- 25
- 26 1. The MAP Lender's contact person as listed on the MAP website.
27 2. The Director of AMCOD, along with a copy of the administrative record.
- 28 E. The lender may request a copy of the administrative record prepared with respect to a
29 Warning Letter.

15.6 MAP Probation

Only the MAP Lender Review Board and the Mortgagee Review Board may place a lender on probation. Probation is intended to be corrective in nature and not punitive. As a result, release from probation is conditioned upon the lender meeting a specific requirement or requirements, such as replacement of a staff member.

A. During the probation period a MAP Lender may:

1. Not submit, and the Hub/PC may not accept, materials after the close of business of the date of the probation letter, for a new:
 - a. MAP Pre-application for a Section 220 or 221(d) project involving new construction, substantial rehabilitation; or
 - b. MAP Firm Commitment application for a Section 223(a)(7) loan or an application for Section 207 pursuant to Section 223(f) project involving a purchase or refinance.

Note: If either a new Pre-application or a new Firm Commitment application for a Section 207 pursuant to Section 223(f) was accepted after the date of the probation letter, it must be returned to the MAP Lender.

2. Continue to process any:

- a. MAP Section 220 or 221(d) project involving new construction/substantial rehabilitation when a pre-application was submitted to a Hub/Program Center before the date of the probation letter.
- b. MAP Section 207 (pursuant to Section 223(f) project involving purchase or refinance when a Firm Commitment application was submitted to a Hub/Program Center before the date of the probation letter.

B. Probation continues until all corrective actions required by the OMP or MAP Lender Review Board (for example, exclusion of a specific staff member from work on MAP loans)

1 are taken by the MAP Lender. When all corrective actions have been taken, the MAP
2 Lender shall notify the OMP. Once the OMP is satisfied that the corrective actions have
3 occurred, the Probation period shall end. A false statement that corrective action has been
4 taken constitutes a false certification as described under Section 15.3, and may constitute a
5 violation of 18 U.S.C. § 1001. A lender's failure to take prompt corrective action after
6 Probation has become final may be the basis for Suspension or Termination.

7 C. Probation is in effect nationwide and the lender's name shall be removed from the MAP-
8 Approved Lender list on the web. When Probation is lifted, the lender's name shall be re-posted.

9 D. The probation notice will be:

10 1. Sent by overnight delivery;

11
12 2. Addressed to the MAP Lender's contact person as listed on the Multifamily MAP
13 website; and

14
15 3. Signed for by an employee of the MAP Lender upon receipt.

16
17 E. Refer to Section 15.12 and 15.13 for sanction and notice procedures.

18 **15.7 MAP Suspension**

19
20 Only the MAP Lender Review Board may suspend a lender's MAP eligibility.

21 Suspension will not exceed 12 months except when special conditions are imposed. If both a time limit
22 and conditions are imposed, suspension will terminate only when the time period has expired, the MAP
23 Lender has submitted a certification of compliance with the conditions to the Board and the Board has
24 notified the lender it is satisfied that the corrective actions have occurred.

25
26 A. During the suspension period a MAP Lender may not:

27
28 1. Submit application materials after the close of business of the date of the suspension

- 1 letter for a new:
- 2 a. Pre-application for a Section 220 or 221(d) project involving new
3 construction/substantial rehabilitation; or
- 4 b. MAP Firm Commitment application for a Section 223(a)(7) loan or an application
5 for Section 207 pursuant to Section 223(f) project involving a purchase or
6 refinance.
- 7 If either a new Pre-application or a new Firm Commitment application for a Section 207
8 pursuant to Section 223(f) was accepted after the date of the suspension letter, it shall
9 be returned to the MAP Lender.
- 10
- 11 2. Continue to process any:
- 12 a. Section 220, or 221(d) project involving new construction/substantial
13 rehabilitation when a pre-application was submitted to a Hub/Program Center
14 before the date of the suspension letter.
- 15 b. Section 207 pursuant to Section 223(f) project involving purchase or refinance when a
16 Firm Commitment application was submitted to a Hub/Program Center before the date
17 of the suspension letter.
- 18 B. The suspension notice will be:
- 19 ○ Sent by overnight delivery;
- 20 ○ Addressed to the MAP Lender's contact person as listed on the Multifamily MAP website;
21 and
- 22 ○ Signed for by an employee of the MAP Lender upon receipt.
- 23
- 24 C. Suspension is in effect nationwide and the lender's name shall be removed from the MAP-
25 Approved Lender list on the web. When Suspension is lifted, the lender's name shall be re-
26 posted.
- 27
- 28 D. Refer to Sections 15.12 and 15.13 below for sanction and notice procedures.
- 29
- 30

15.8 MAP Termination

Only the MAP Lender Review Board may terminate a lender's eligibility for MAP.

- A. A terminated lender may not submit, and the Hub/PC may not accept, materials after the close of business of the date of the termination letter for a new:
1. Pre-application for a Section 220 or 221(d) project involving new construction/substantial rehabilitation; or
 2. MAP Firm Commitment application for a Section 223(a)(7) loan or an application for Section 207 pursuant to Section 223(f) project involving a purchase or refinance.
- B. Any MAP pre-application or MAP application in process may no longer be processed by the terminated lender. The lender will either:
1. Immediately transfer the transaction to the TAP procedure and the Hub/PC will completely reprocess all stages of the transaction; or
 2. Immediately transfer the project to a new MAP Lender. The new MAP Lender must completely reprocess all stages of the transaction. At no time may the new MAP Lender assign the Pre-application, the firm application, the mortgage insurance commitment, or the insured construction loan back to the original MAP Lender.
- C. The Department will not endorse any MAP loan processed by the terminated lender unless a Firm Commitment was issued before the date of termination.
1. Firm Commitments involving new construction or substantial rehabilitation must be immediately transferred to a new MAP Lender. At no time may the new MAP Lender assign the Firm Commitment, or the insured construction loan, back to the original MAP Lender.
 2. Firm Commitments issued for Section 223(f) projects may be transferred before final endorsement to any approved MAP Lender or kept in the lender's portfolio.

1 settlement agreement. Once an action is referred to the MAP Lender Review Board,
2 only the Board may approve the settlement agreement.

3
4 B. Settlement agreements may provide for:

- 5 1. Cessation of any violation.
6
7 2. Correction or mitigation of the effects of any violation.
8
9 3. Removal of lender staff from positions involving origination, underwriting and/or
10 construction loan administration.
11 4. Actions to collect monies wrongfully paid by the MAP Lender to a third party.
12
13 5. Implementing or revision of a Quality Control Plan or other corrective measure
14 acceptable to HUD.
15 6. Modification of the duration or provisions of any administrative sanctions HUD deems
16 appropriate.

17 C. A MAP Lender's compliance with a settlement agreement is evidenced by certifying its
18 compliance with the conditions of the agreement and by HUD determining that the lender is in
19 compliance with the conditions of the agreement.

20 D. Failure by a MAP Lender to comply with a settlement agreement may result in referral to
21 the MAP Lender Review Board or the Mortgagee Review Board for probation,
22 suspension or termination.

23 **15.10 MAP Lender Review Board**

24
25 A. The Board is authorized to take action against any MAP Lender that violates MAP
26 requirements.

27 B. Composition.

- 28 1. The Board shall consist of three Multifamily Housing Officials designated by the
29 DAS for Multifamily Housing.
30 2. Board Members
31 a. Are selected from among Hub and Program Center Directors or Multifamily
32 Housing employees.
33 b. May serve on a continuing basis or may be chosen for the particular review, as

-
- 1 the DAS determines.
- 2 c. Shall have no prior business affiliation or other conflicts of interest with the
- 3 lender under review.
- 4 d. Shall select one of their members to act as Chairman of the MAP Lender
- 5 Review Board.
- 6 e. Are expected to have knowledge of multifamily housing origination,
- 7 underwriting and construction loan administration procedures.
- 8 3. The following individuals cannot serve on the Board:
- 9 a. The Hub/Program Center Director making the recommendation;
- 10 b. Staff from the Hub/Program Center making the recommendation;
- 11 c. The Director of OMP or AMCOD; and
- 12 d. Staff from OMP and AMCOD
- 13 C. Non-voting Advisors to the Board.
- 14 1. Designee of the Office of Inspector General
- 15 2. Designee of the Office of General Counsel
- 16 D. The Director of OMP or AMCOD or his/her designee presents the cases to the MAP Lender
- 17 Review Board
- 18 E. Functions, Duties and Powers.
- 19 1. The MAP Lender Review Board is authorized to impose appropriate sanctions on a
- 20 MAP Lender after:
- 21 a. Conducting an impartial review of all information and documentation submitted
- 22 to the board; and
- 23 b. Making factual determinations that there has been a violation of MAP
- 24 requirements.
- 25 2. In determining what action is appropriate, the Board will consider among other
- 26 factors:
- 27 a. The seriousness and extent of the violation(s);
- 28 b. Any history of prior offenses;
- 29 c. Deterrence of future violations;
- 30 d. Any inappropriate benefits received by the MAP Lender;

- 1 e. Potential inappropriate benefit to other persons; and
- 2 f. Any mitigating factors.
- 3 3. The Board may refer:
 - 4 a. A MAP Lender to:
 - 5 (1) The Mortgagee Review Board for possible termination as a HUD-FHA
 - 6 approved mortgagee or lender, and/or imposition of civil money penalties
 - 7 for knowing and material violations of HUD-FHA requirements (see
 - 8 Section 15.17)
 - 9 (2) The Office of Inspector General
 - 10 b. An individual or firm involved in a “covered transaction,” as defined in 2 CFR
 - 11 2424.220 to the DAS for imposition of an LDP which may be imposed on a
 - 12 nationwide basis or on a more restricted geographic basis.

14 **15.11 Support Staff for MAP Lender Review Board**

- 16 A. The Chairman of the Board supplies the clerical staff for the MAP Lender Review Board.
- 17 The clerical staff:
 - 18 1. Coordinates Board activities with other HUD offices and government agencies.
 - 19 2. Develops the agenda and policy issues for Board meetings.
 - 20 3. Notifies a MAP Lender of any sanction imposed by the Board.
 - 21 4. Notifies a MAP Lender, when the Board is to consider sanctions.
 - 22 5. Keeps the official minutes of the Board and the case files and all Board actions.
 - 23 6. Drafts all notices, orders, letters, and directives on behalf of the Board.
 - 24 7. Performs other duties assigned by the Chairman or as directed by the Board.
- 25 B. The Office of Multifamily Production staff serves as the prosecutor and:
 - 26 1. Are the contacts on all matters concerning the Board.
 - 27 2. Presents the sanction cases to the Board.
 - 28 3. Collects, analyzes, prepares and submits to the Board the charging document and
 - 29 supporting documentation together with possible options or recommendations as to
 - 30 sanctions against a MAP Lender.
 - 31 4. Refers cases for Board consideration.

- 1 5. Negotiates settlement agreements with MAP Lenders.
- 2 6. Prepares the administrative record of all matters before the Board.
- 3 C. Office of Inspector General
- 4 1. Refers MAP Lenders for Board consideration as a result of audits or investigations.
- 5 2. Performs audits or investigations of approved MAP Lenders.
- 6 D. Office of General Counsel
- 7 1. Advises the Board as to the legal sufficiency of actions it proposes to take.
- 8 2. Assists the Board in the drafting of Board decisions and orders.
- 9 3. Assists the Director of OMP or AMCOD in settlement negotiations.
- 10 4. Provides other legal advice as requested by the Board.
- 11

12 **15.12 Procedures for Sanctions**

- 14 A. Requests for MAP Lender Review Board Action. The Director of OMP or AMCOD, or
15 his/her designee, may refer a MAP Lender to the Board for consideration of sanctions.
 - 16 1. Any referral from a Hub Director must be sent to the Director of OMP or AMCOD.
 - 17 2. The referral must contain a written report, which includes:
 - 18 a. A full factual background description of the violations;
 - 19 b. Specific citations of the Department's requirements that have been violated; and
 - 20 c. All available supporting documentation that bears upon the violations (the
21 administrative record discussed earlier)
 - 22 3. There is no notification to the lender until the Board is constituted and receives the
23 charging documents from the Director of OMP or AMCOD. (At that point,
24 notification under Section 15.13 is automatic, and does not require substantive
25 consideration by the Board of the nature of the charge.)
- 26 B. Appointment of the Board
27 When the Director of OMP or AMCOD intends to send a referral to the MAP Lender
28 Review Board, s/he requests the DAS to appoint a Board, as described in Section 15.10.
- 29 C. Initial Consideration by the Board
30 When the Board receives a referral from the Director of OMP, the Board members may
31 confer by email or by conference calls or in person. Any record of confidential

1 communications between and among Board members at this stage of the proceedings is
2 privileged from disclosure and will not be part of the administrative record of any matter.

3 D. Informal Conference

4 1. The lender may request an informal conference as discussed in Section 15.13, which the
5 Board will schedule.

6 2. After notifying the lender and permitting the lender an opportunity to respond, the Board
7 will meet with the lender or its designees and with the Director of OMP and his/her designees
8 to review documentary evidence and presentations by both sides (see Section 15.13).

9 a. Transcript of the informal meeting.

10 (1) No transcript of this informal meeting will be made, unless the lender elects to
11 have a transcript made by a certified court reporter at its own expense. If the
12 lender elects to have a transcript made, it must provide three copies of the
13 transcript to HUD within five business days of the informal meeting. The
14 transcript will not become a part of the record unless it is submitted within the
15 5-day time frame.

16 (2) If a transcript is not provided within the time limit set forth above, oral
17 statements made at the informal meeting will not be considered as part of the
18 record, except that the Board may consider voluntary admissions, made by a
19 representative of the lender, of any element of the violation charged.

20 b. Any additional documents, evidence, or written arguments, which the lender wishes to
21 present to the Board, must be presented within five working days after this informal meeting.

22 E. Action by the Board.

23 1. Upon consideration of evidence submitted by the Director of OMP or AMCOD and the MAP
24 Lender, the Board will confer and make a final decision regarding the matter.

25 2. Any final decision by the MAP Lender Review Board placing a lender on Probation, or
26 Suspension, or Terminating a lender shall be in writing and shall state the reasons for the decision
27 and the facts supporting those reasons. Higher level officials and decision makers, including the
28 MAP Lender Review Board, are not bound by the recommendations from other HUD officials
29 described above, except that the Board may not take any action against a lender which is more
30 severe than the action recommended by the Director, OMP or AMCOD. In any case where the
31 action taken or the recommendation made differs from the recommendation received, that
32 difference shall be explained in writing.

33 F. Effective Date of Action.

1 Unless the Board decrees that a later date should apply, any sanction (probation, suspension or
2 termination) shall become effective on the date of the Notice of Action to the lender.

3 G. The lender may appeal the Board's decision to the DAS for Multifamily Housing or his/her
4 designee, as specified in Section 15.15.

5 **15.13 Notice of Violation**

6
7 A. Before the MAP Lender Review Board reviews a matter for consideration of a sanction, the Board's
8 Chairman will issue written notice of the proposed action to the MAP Lender's contact person as
9 listed on the Multifamily MAP web site. The notice is sent by overnight delivery and must be signed
10 for by an employee of the MAP Lender upon receipt. The notice:

- 11 1. Informs the lender that the Board is considering a specific violation.
- 12 2. States the specific alleged factual violations with citation to the Department's requirements that
13 have been violated.
- 14 3. Includes as attachments copies of all documents evidencing the violation or upon which the
15 Board will be asked to rely in reaching a decision.
- 16 4. Provides the lender with the opportunity, within 15 business days from the date of the issuance of
17 the proposed action, to:
 - 18 a. Meet informally with the Board in person or by video conference using HUD facilities at
19 Headquarters or one of the various Hub/PCs; and/or
 - 20 b. Present written evidence and any other relevant information.
- 21 5. Offers the MAP Lender the opportunity to reply in writing to the Board within 15 business days
22 from the date of the issuance of the proposed action. Failure to reply may result in a
23 determination by the Board without considering the MAP Lender's comments.
- 24 6. Requires the response to be addressed to the Chairman of the Board. The response may not
25 exceed 15 double-spaced typewritten pages and must include an executive summary, a statement
26 of the facts, an argument and a conclusion. All written material and supporting documentation
27 must be submitted in triplicate.

28 Accompanying the notice of violation is a copy of the charging document and all of the supporting
29 documentation that has been submitted to the Board.

30 B. The MAP Lender Review Board has the power to issue a Notice of Action discussed in Section 15.14
31 to terminate a lender, or to place a lender on probation or suspension without advance notice to the

1 lender when there is an imminent need to protect the financial interests of the Government. No such
2 action shall be taken except upon the written recommendation of the Director of OMP and approval
3 of the DAS for the Office of Multifamily Housing Programs upon a determination by the Board that
4 immediate action is necessary. In every such case, the lender shall be promptly notified of the
5 Board's decision and the reasons for it, and shall have the right to submit materials to the Board and
6 appear before the Board to seek a prompt reconsideration of the Board's decision.

7 **15.14 Notice of Action**

- 8
- 9 A. A prompt decision is important when the Office of Multifamily Housing Programs acts to
10 place a MAP Lender on probation. The DAS will issue the final decision within 10 business
11 days of the receipt of the lender's information and/or the informal conference.
- 12 B. The OMP or AMCOD will notify the MAP Lender of its final determination by overnight
13 delivery of a written notice of the final decision to the MAP Lender's contact person as
14 listed on the Multifamily MAP web site.
- 15 C. The final decision will:
- 16 1. State the nature and duration of the action.
 - 17 2. State the violations and any factual findings.
 - 18 3. Inform the MAP Lender of its right to an appeal conference.
 - 19 4. May add or modify the reasons for the decision as stated in the initial notice.
- 20 D. A copy of the administrative record will be sent to the lender by overnight express within one
21 business day after the issuance of the final decision.

22 **15.15 Appeals**

- 23 A. Appeal Conference.
- 24 1. Whenever HUD imposes a sanction of probation, suspension or termination against a
25 MAP Lender, the lender may, within 10 business days of receiving the sanction letter,
26 request in writing, an appeal conference before the appeals official. The Appeals
27 Official must be an individual who has not previously been involved with the
28 proceedings or settlement discussions up to this point.
 - 29
 - 30 2. No transcript of the appeal conference-will be made, unless the lender elects to have a

- 1 transcript made by a certified court reporter at its own expense. If the lender elects to
2 have a transcript made, it must provide three copies of the transcript to HUD within
3 five business days of the informal meeting.
4
- 5 3. Oral statements made by any participant at this meeting are not considered as
6 evidence on any matter under consideration, except that the Appeals Official may
7 consider voluntary admissions by a representative of the lender of any element of the
8 violation charged.
9
- 10 4. Any additional written arguments, which the lender wishes to present to the
11 Appeals Official, must be presented within five business days after the date of the
12 appeal conference.
13
- 14 5. While the appeal is pending, the notice of action is in effect.
- 15 B. The appeal conference regarding the Board's action will be held within 10 business days
16 of HUD receiving the MAP Lender's appeal request.
17
- 18 1. The Director of OMP provides the administrative record to the Appeals Official and
19 points out the evidence on which the decision was made; and
20
- 21 2. The MAP Lender may provide oral arguments in support of its position and the
22 evidence previously submitted. No new evidence may be submitted to the Appeals
23 Official at this point.
24
- 25 C. A MAP Lender may voluntarily request and the Appeals Official may agree to have an
26 appeal conference held more than 10 but not more than 30 business days after the date of
27 the lender's request for an appeal.
28
- 29 D. Within 10 business days after the date of the appeal conference, or the expiration of the
30 period allowed for the submission of documents and written arguments, whichever is
31 later, the Appeals Official makes a written determination. S/he may confirm, modify, or
32 overturn the MAP Lender Review Board's decision.
33

- 1 E. If the MAP Lender does not request a conference within 10 business days of receiving the
2 sanction letter, the right to a conference will be considered waived.
3
- 4 F. If the Appeals Official overturns the MAP Lender Review Board's decision, the lender
5 shall immediately return to an active status as a MAP Lender. The active status of the
6 MAP Lender will be posted on the HUD web.
7
- 8 G. Participation in the appeal process is not a prerequisite to filing of an action for judicial review
9 under the Administrative Procedure Act.

10 **15.16 Limited Denial of Participation**

11
12 The criteria and procedures in this section apply to suspensions and debarments as well as to
13 limited denials of participation. See Chapter 4 of OGC Handbook 1300.13 REV 1, Debarment,
14 Suspension, and Ineligibility of Participants and Contractors, and HUD Regulations at 2 CFR
15 2424. In case of any conflict between this section and the foregoing authorities, those
16 authorities control.

- 17 A. An LDP may be imposed upon any participant or contractor and its affiliates, except
18 HUD-FHA approved mortgagees. Examples of participants that may be sanctioned are
19 (but are not limited to):
- 20 1. Independent Fee Appraisers
 - 21 2. Third Party Cost Analysts
 - 22 3. Needs Assessors
 - 23 4. Environmental Analysts and Engineers
 - 24 5. General Contractors
 - 25 6. Architects
 - 26 7. Specific underwriters or loan analysts
 - 27 2. Application Sponsors
- 28
- 29 B. Once issued, the LDP may apply to any contractor, participant or to a participating
30 organization. For example, a specific appraiser may be issued a LDP, or an entire

1 appraisal firm may be issued a LDP. A LDP may also apply to all affiliates of that
2 contractor or participant at the discretion of the imposing official.

3 C. Conditions Warranting Referral to HQ Recommending Consideration for a National
4 LDP.

5 Referral to Headquarters for recommendation for a National LDP shall be at the
6 discretion of the Hub Director. When it is determined that the offense warrants such a
7 measure, the Hub Director should forward all pertinent information along with a formal
8 recommendation to the Deputy Assistant Secretary for Multifamily Housing for review.
9 The recommendation should include:

- 10 1. All related processing associated with the case(s) that initiated the action.
- 11 2. A narrative summary detailing the description and nature of the alleged offense(s)
12 committed.
- 13 3. A synopsis of the participant's historic performance in past cases dealing with the
14 Department.
- 15 4. A recommend course of action to be taken.

16 D. Questions should be addressed to the Director of the Compliance Division of the
17 Enforcement Center.

18 **15.17 Referral to the Mortgagee Board or the Inspector**
19 **General**

20
21 A. If the Hub/PC Director determines that a MAP Lender's actions or failure to act appears
22 to be a compliance matter justifying action by the Mortgagee Review Board, including
23 possible removal of its authority to do business as an FHA Lender, s/he must bring this
24 matter and the administrative record to the attention of the Director, Office of
25 Multifamily Production in Headquarters. The Director will refer the matter to the
26 Director of the Mortgagee Review Board Division in the Departmental Enforcement
27 Center.

28
29 ***See Section 2-4, Requests for Mortgagee Review Board Action, HUD Handbook 4060.2 REV 2,***
30 ***Mortgagee Review Board, and HUD Regulations at 24 CFR 25.***

1

2 B. If the issue involves possible fraud, material misrepresentation or other criminal
3 violations, then the matter should be referred to the Office of Inspector General.

4

5 *See Section 3-1, Responsibilities of Departmental Management and Employees, OIG*
6 *Handbook 2000.3 REV-4, Office of Inspector General Activities.*

7 **15.18 Other Enforcement Actions**

8

9 Notwithstanding any provisions contained elsewhere in this Guide, HUD reserves the right to
10 pursue remedies for false claims and false statements, as authorized by the False Claims Act,
11 31 U.S.C. §§ 3729-3731, and the Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801-
12 3812.

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Chapter 16 Master Lease Structuring to Facilitate the use of Tax Credits

Master Leases are used to maximize the benefits of combining some or all of the following tax credit sources: Federal or State Historic Tax Credits, New Markets Tax Credits and Low Income Housing Tax Credits. Master Leases can be advantageous to investors and developers participating in these programs by providing maximum leverage for project financing and premium pricing for equity while reducing the need for additional debt. However, the use of master leases in multifamily insured projects has been limited, and therefore this section has been removed from the MAP Guide. The structuring of master leases in multifamily insured transactions will be reviewed on a case by case basis until such time as additional policy guidance is issued.

DRAFT

Chapter 17 Refinancing Cooperative Housing Projects under Section 207 pursuant to Section 223(f)

17.1 Introduction

The following provides processing instructions for refinancing Cooperative Housing Projects under the Section 207 pursuant to Section 223(f). This applies solely for refinancing a project and does not apply to projects that include an acquisition. Please note that proposed conversions or projects undergoing conversion, to cooperatives are not eligible for refinancing under this chapter.

17.2 Background

Cooperative ownership is popular in certain parts of the country, especially for low-to-moderate-income occupants. HUD already insures traditionally processed mortgage loans to facilitate the construction and substantial rehabilitation of Cooperative Housing projects under Section 213. Facilitating the refinancing of a Cooperative under Section 223(f) will further the Department's mission by assisting eligible Cooperative projects to obtain refinancing to make necessary repairs and/or consolidate more expensive outstanding debt, thereby serving to preserve the affordable housing stock. Refinancing the existing underlying mortgage is considered to be a better alternative than expending a Cooperative's reserve fund, which would have a negative impact on its financial stability and would help to avoid the need for a special assessment, which could harm low-to-moderate income occupants, especially those on a fixed income.

17.3 Program Requirements

The Underwriting Summary must demonstrate compliance with all program requirements.

- A. Loan Parameters. In accordance with Section 3.8.O, HUD will insure a mortgage for a maximum term of 35 years or 75% of the remaining economic life of the property, whichever is less. The maximum insurable mortgage amount shall be the lesser of the following parameters as they relate to the criteria in Form HUD-92264-A, "Supplement to Project Analysis": (NOTE - An equity take out from a refinancing loan is not

1 permitted for cooperative housing projects.)

2 1. Criterion 1. Mortgage or Loan Amount Requested in Application.

3 2. Criterion 3. Amount Based on Value or Replacement Cost. The lesser of market
4 value, valued as a market rate rental project multiplied by a loan ratio of 65%, or the
5 Gross Sell-off Value, as a market rate cooperative project multiplied by a loan ratio of
6 55% (value definitions are contained in Section II.B).

7 3. Criterion 4. Amount Based on Limitations per Family Unit. Use Section 207
8 statutory per unit limits, adjusted by the local PC High Cost Percentage for the
9 locality. Follow the outstanding instructions for Criterion 4.

10 4. Criterion 5. Amount Based on Debt Service Ratio. A mortgage amount supported by
11 1.0 debt coverage based on the projected NOI as an existing Cooperative project
12 based on its historic occupancy rate (up to 100%), which is NOI noted on line “5.e”.*

13 *NOTE: In addition to the calculation of Criterion 5, the underwriter must perform a
14 feasibility test comparing Criterion 5 as calculated above to a Criterion 5 calculation
15 on a mortgage amount supported by a 1.538 debt service coverage based on projected
16 NOI as a market rate rental project, which is NOI multiplied by 65%. The occupancy
17 percentage for this scenario may not exceed 93%. This will be reported on page 4,
18 “Remarks” of Form HUD-92264-A. If the amount based on NOI as an existing
19 Cooperative project exceeds the amount based on NOI as a market rate rental project,
20 the underwriter must comment on the feasibility of the project to continue as a
21 Cooperative.

22 5. Criterion 7. Criterion 7 is not to be completed since acquisitions are ineligible.

23 6. Criterion 10. Amount Based on Existing Indebtedness, Repairs and Loan Closing
24 Charges. Follow outstanding instructions. The cost to refinance includes funding, if
25 applicable, the Initial Funding of the Replacement Reserve and the Initial Deposit to
26 the General Operating Reserve (see Section 17.3.F below). No equity out is
27 permitted under Section 223(f) when refinancing Cooperatives, accordingly, the
28 calculation for this criterion stops at line “10.g”.

29 7. Criterion 11. Amount Based on Deduction of Grants and Gifts and Loans. Line
30 “11.a” shall be the cost to refinance plus FHA Mortgageable items taken from Line
31 “10.g”. Line “11.b” shall be total of grants, gifts and loan intended to offset the cost
32 of mortgageable items. Line “11.c” shall be Line “11.a” minus Line 11.b”.

33 B. Eligible Borrowers. Eligible borrowers include nonprofit Cooperative Ownership
34 Housing corporations or nonprofit Cooperative Ownership Housing trusts regulated
35 under state law and regulatory agreements that require membership eligibility and
36 transfer of membership in a manner approved by HUD. Limited profit ownership entities

1 such as those established under the Mitchell-Lama program in New York City may be
2 acceptable pending review by local Counsel.

3 C. Application Processing. Applications for Cooperatives are processed in accordance with
4 the current Section 223(f) instructions except as modified here.

5 D. Required Exhibits. All exhibits normally required for a Section 223(f) application must
6 be submitted with the following modifications and additions.

7 1. Rent Roll. The Rent Roll should be modified to indicate each shareholder's name,
8 unit location, mailing address, whether or not the unit is owner occupied, whether or
9 not the unit is subsidized, date of occupancy, ownership percentage, amount of
10 monthly maintenance charge, any special assessments and past due balances of 30
11 days or more. For any units subject to local rent control, the actual rent must be
12 substituted for the maintenance fee amount. The Rent Roll should be submitted as an
13 Excel spreadsheet.

14 2. Cooperative Membership Exhibit. Subsequent to issuance of the commitment and
15 prior to closing, the lender must submit a statement of the cost to the borrower and
16 the Cooperative Membership Exhibit, Form HUD-93203. The number of members
17 must equal the percentage (or number) of the total number of units as specified in the
18 commitment.

19 3. Original Project Prospectus (if available). The prospectus is prepared at the time of
20 the original public filing and contains a great deal of useful information for technical
21 discipline processing by HUD as well as the underwriter and preparers of third-party
22 reports.

23 4. Financial Statements for the Past Three Years. Follow the current instructions
24 contained in Section 7.8.B and Section 8.4. The lender should review and evaluate
25 any qualifications contained in the reviews to ensure the financial statements reliably
26 represent the property's operating history and the assumptions relied on in the
27 underwriting and should pay particular attention to the history of total past due
28 balances of maintenance fees and special assessments. The total amount of the
29 unpaid balance (30 days or more) for maintenance charges and special assessments as
30 shown in the rent roll must not exceed 5% of the gross annual income.

31 5. Environmental Exhibits.

32 a. Contamination Analyses. A Phase I ESA, if necessary a Phase II ESA, and, if
33 further necessary, a remediation plan are required. See Chapter 9.

34 b. Environmental Report. As described in Chapter 9, an Environmental Report is
35 required.

- 1 6. Additional Third-Party Reports. HUD may require additional specialized reports to
2 ascertain the safety and soundness of the property and its amenities as to their
3 suitability as collateral for long-term financing.
- 4 7. Organizational Documents and Minutes. The Hub/PC will provide the documents set
5 forth in Handbook 4550.3, Existing Construction – Cooperative Housing. The
6 following additional exhibits are required:
 - 7 a. Certificate of Incorporation FHA Form No. 3234-B.
 - 8 b. Resolution of Board of Directors to Mortgage Cooperative.
 - 9 c. Shareholders authorization to Mortgage Cooperative.
 - 10 d. Resolution of Board of Directors adopting FHA Form No. 3245, "Model Form of
11 By-laws."
 - 12 e. Shareholders authorizing adoption of FHA Form No. 3245, "Model Form of By-
13 laws."
 - 14 f. Minutes of the last six Board of Directors meetings.
 - 15 g. Resolution of Board of Directors adopting FHA Form No. 3237, "Model Form of
16 Occupancy Agreement."
 - 17 h. Resolution of Board of Directors adopting FHA Form No. 3237-A, "Model Form
18 of Sublease."
- 19 E. Project Eligibility. The property must contain at least 5 residential units with complete
20 kitchens and baths, and have been completed or substantially rehabilitated for at least 3
21 years prior to the date of application. Properties that were substantially rehabilitated with
22 HUD-insured mortgages that have been completed with an expired latent defects
23 guarantee are exempt from the Three Year-Rule. If the Cooperative was a conversion,
24 the conversion must have been completed at least three years prior to the application date.
25 Proposed conversions or projects undergoing conversions are not eligible. Projects with
26 a recent or unresolved vacancy history, or a history of shareholders not paying dues,
27 maintenance fees and other co-op obligations, will not be considered for mortgage
28 insurance. The project must be fully subscribed, with no units owned by the original
29 developer, prior to endorsement and must meet these additional criteria:
 - 30 1. Project Design. The project must be designed for primary residence only.
31 Timeshares, resorts, Cooperative hotels or rental pools are not permitted. Section 513
32 of the National Housing Act prohibits the use of the insurance programs for transient
33 or hotel purposes. The borrower and individual shareholders cannot execute
34 Occupancy Agreements for less than 30 days nor provide occupants with hotel
35 services such as maid service, furnishing and laundering of linens, room service and
36 bellboys. Units may not be sub-leased without the consent of the Cooperative
37 Corporation.
 - 38 2. General Market Conditions. The Property must be located in an area evidencing
39 strong market understanding and acceptance of Cooperative housing. Financing for

- 1 the purchase of individual shares must be readily available from mortgage
2 bankers/brokers, banks or saving and loan institutions. The Underwriting Summary
3 must cite recent sales within the building and indicate the type of financing utilized.
- 4 3. Repair Threshold. A project cannot be processed under Section 223(f) if it meets the
5 current requirements for substantial rehabilitation in Section 5.12. Projects that are
6 not eligible for mortgage insurance under Section 207 pursuant to Section 223(f)
7 should consider the Section 213 or Section 221(d)(3) programs.
- 8 4. Fair Housing Act / Equal Opportunity Requirements. All other applicable program
9 requirements for the Section 207 pursuant to Section 223(f) program must be met,
10 including compliance with applicable Civil Rights Laws, including the
11 nondiscrimination and affirmatively furthering fair housing provisions of the Fair
12 Housing Act, and applicable accessibility requirements for persons with disabilities.
- 13 a. Affirmative Fair Housing Marketing. The Affirmative Fair Housing Marketing
14 Requirements (24 CFR Part 200, Subpart M) apply to all insured projects of five
15 or more units but projects insured under Section 207 pursuant to Section 223(f)
16 are exempt from the submission of a written plan. However, a Section 223(f)
17 applicant is required to maintain records of its affirmative marketing efforts.
18 Except in the case of a project specifically designed exclusively for the elderly
19 (see below), the borrower must certify that it will not discriminate against families
20 with children.
- 21 b. Accessibility for Persons with Disabilities. This is required for properties built
22 after March 13, 1991, containing Fair Housing Act noncompliance. If a project
23 built after March 13, 1991, is submitted for Section 223(f) refinancing and the
24 PCNA inspection reveals that it contains noncompliance with the Fair Housing
25 Act design and construction requirements, the Department must require that the
26 owner correct the noncompliance as a condition of insurance. The extent of the
27 noncompliance and the cost of correction will determine whether the project is
28 feasible as a Section 223(f) or whether to resubmit it as a substantial
29 rehabilitation. In no case may the Department insure projects with outstanding
30 Fair Housing Act noncompliance.
- 31 5. Elderly Developments - (aka Golden Age Cooperatives). In refinancing of the
32 underlying mortgage for an existing Cooperative project designed for the elderly, the
33 Department defines the term “elderly person” in the National Housing Act (NHA) as
34 a household composed of one or more persons at least one of whom is 62 years of age
35 or more at the time of initial occupancy. Waiver of this definition is not permitted
36 under any circumstances. It is noted that this definition differs from the definition in
37 use for Section 213 of the NHA. The Cooperative shall not provide mandatory meals
38 and services such as those associated with retirement service centers. No non-shelter
39 services can be a mandatory condition of occupancy and must be reviewed by the

1 lender and approved by the Hub/PC for reasonableness. Non-shelter spaces already
2 constructed for projects with current HUD-insured mortgages may include formal
3 dining areas with meal services to be provided on an optional basis. All Cooperatives
4 can provide modest kitchen equipment in a non-shelter space for the use of occupants
5 or for catering services. The kitchen should be sufficient in size to support sanitary
6 requirements. Additional requirements related to the provision of meals are as
7 follows:

- 8 a. Any meal service must be provided on an optional basis.
- 9 b. The cost of meals may not be included in the residents' rental charges.
- 10 c. The costs associated with the operation of the meals service are the responsibility
11 of the entity that operates the optional meal service.
- 12 d. The borrower may receive payment from the operator of the meals service. In
13 such cases, this revenue may not be included in the underwriting of the project, as
14 this service is optional for each resident, thereby potentially producing a revenue
15 stream that is both unpredictable and unreliable.
- 16 e. A determination should be made by the lender that the expenses associated with a
17 third-party meal provider will not increase the project risk.
- 18 f. Any meal service must be operated by a meal provider licensed under State or
19 local law and in compliance with current health and safety requirements for food
20 service providers.
- 21 g. Local HUD Counsel must determine that the granting or revocation of any
22 licensing required to operate a proposed meal service will not jeopardize the
23 ability of the project to operate as Cooperative Housing in accordance with the
24 requirements of the Regulatory Agreement.
- 25 h. Costs associated with developing a facility insured under Section 223(f) to
26 include a meal service may be considered in the mortgage, subject to outstanding
27 requirements limiting non-shelter space and commercial areas.

28 6. Owner Occupancy. At least 75% of the total number of residential units must be
29 owned and occupied by Cooperative members at the time of endorsement, and no
30 more than 25% of the units may be owned by investors.

31 7. Vacancy Rate. The project should not have a vacancy rate greater than 5% since a
32 higher vacancy rate may indicate a weak or problematic project or market. If an
33 application is presented with a higher vacancy rate, the underwriter must provide
34 convincing market evidence to support the transaction in the Underwriting Summary.
35 The vacancy/occupancy rate used in underwriting the loan should be based on the
36 actual historic performance of the project, which can be 100%. This applies only to
37 Criterion 5 based on actual operation as a Cooperative project.

- 1 9. Turnover Rate. The sales history of the complex should display a healthy turnover
2 rate to demonstrate that the project is viable and that there is demand for the units. If
3 the turnover rate is less than 5% of the total number of owner-occupied units per year,
4 the underwriter must determine the reasons for the low turnover rate and why it does
5 not pose an unacceptable risk, which must be documented in the Underwriting
6 Summary. However, it should be noted that a project and/or market area may have a
7 historically low turnover rate due to its popularity as a source of affordable housing.
- 8 10. Adequacy of the Proposed Carrying Charges. The carrying charge must be sufficient
9 to adequately maintain the project at a level that would make it suitable as security for
10 a long-term mortgage. The Underwriting Summary must contain an analysis of the
11 Appraiser's findings regarding the adequacy of the proposed carrying charge that will
12 be in place after refinancing has occurred and a discussion of the Cooperative
13 project's policy and history regarding increasing the carrying charge. The
14 Cooperative's Bylaws or other appropriate organizational documents must contain a
15 provision that requires an annual increase in the carrying charge based on inflation, in
16 order to address increases in operating expenses.
- 17 11. Carrying Charge Increase. In general, the debt service resulting from the proposed
18 mortgage should not require a carrying charge increase of more than 5%, which may
19 be exceeded, so long as all of the following requirements are met:
 - 20 a. The carrying charge is below market for properly maintained similar projects, and
21 is not sufficient to adequately maintain the project.
 - 22 b. The Board of Directors must approve the carrying charge increase in accordance
23 with its By-laws the FHA Model Form of By-laws, FHA Form No. 3245.
 - 24 c. An analysis of the demographic data in the appraisal report must indicate the new
25 maintenance fee would be affordable for the typical resident.
 - 26 d. Market analysis of the proposed maintenance carrying charge indicates that it is
27 within market limits for similar projects in the subject's market area.
- 28 12. Commercial Space Limitations. The current Section 223(f) parameters must be
29 followed.
- 30 13. Ownership of Commercial Space/Parking. Commercial and parking space at a
31 Cooperative Housing project may or may not be owned by the Cooperative. Only
32 those spaces that are owned by the Cooperative may be included as part of the
33 collateral.
- 34 14. Ground Leases. Ground Leases must conform to the FHA Lease Addendum Form
35 HUD-92070M. The term of the lease addendum may be varied to conform with
36 applicable State and local law, except that the local HUD Closing Attorney must
37 approve:

- 1 a. The legal need for any proposed lease term changes, and
2 b. That any term changes are consistent with the following requirements:
3 (1) Term is 99 years and is renewable, or
4 (2) Term is at least 50 years from the date the mortgage is executed (where a
5 lease is on trust/other land on a reservation the HUD Closing Attorney must
6 ensure that the lease provisions are coordinated with Bureau of Indian Affairs'
7 requirements).
- 8 F. General Operating Reserve (GOR). Cooperatives are required by the Regulatory
9 Agreement, FHA Form No. 3225 to establish and maintain a GOR which is a percentage
10 of the monthly carrying charges. The carrying charge is the sum of all project expenses,
11 replacement reserve, taxes and debt service.
- 12 1. GOR formula.
- 13 a. The GOR is maintained by a monthly payment of 3% of the monthly carrying
14 charges.
- 15 b. When the GOR account reaches 15% of the annual carrying charges, the monthly
16 rate may be reduced to 2%.
- 17 c. When the GOR account reaches 25% of annual carrying charges, monthly
18 accruals may be discontinued until the account is reduced below 25%.
- 19 d. Anytime the GOR falls below the 25% level, monthly payments to the account
20 shall be resumed at a 2% to 3% rate, as noted above, until the 25% level is
21 restored.
- 22 2. In addition to any Initial Deposit to replacement reserve, the Cooperative borrower
23 may be required to make an Initial Deposit to the GOR not to exceed 15% of the
24 annual carrying fee. The Initial Funding of the GOR using this provision may be
25 included in the cost of refinancing up to an amount equal to 15% of the annual
26 carrying fee.
- 27 G. Model Forms and Closing Documents. Use Handbook 4550.3, Existing Construction –
28 Cooperative Housing, Appendix III (modified for Section 223(f)). Cooperative
29 Organizational forms and documents must be reviewed and approved for legal and
30 programmatic compliance before the issuance of a Firm Commitment. Use FHA
31 Required Closing Instruments, FHA Form No. 3257-B, also set forth in Handbook
32 4550.3, Appendix 3-10. (See Section 17.3.D.7 above). The Hub/PC will provide the
33 documents set forth in Handbook 4550.3.

34 **17.4 Program Requirements – Technical Processing**

- 1 A. Architectural and Cost Processing for Cooperatives. Follow the current instructions for
2 Section 223(f). A summary of these procedures is outlined below.
- 3 1. Architectural Analysis. Lender will submit and HUD will review deliverables as
4 specified under the present guidance for Section 223(f) to the Hub/PC.
- 5 2. Cost Processing. The HUD Cost Analyst will review lender exhibits as required in
6 Chapter 6 and will recommend either acceptance or rejection of the Cost portion of
7 the Firm submission.
- 8 1. PCNA. The primary purpose of the PCNA for a Cooperative project is to assess the
9 Capital Needs of the project with the exception of any elements owned by the
10 individual shareholders. So, it is very important to ascertain exactly what items are
11 the sole responsibilities of the Cooperative. In some cases, appliances, kitchen
12 cabinets, etc. may actually be owned by the Cooperative. The interior of individual
13 units are still inspected in the same manner as with apartments. Any hazards or
14 defects that would affect safety and marketability of the Cooperative should be
15 noted even if it is an individual shareholder's responsibility. These items must be
16 corrected at the shareholder's expense prior to endorsement. Mortgage proceeds
17 must only be used for repairs of property owned by the Cooperative.
- 18 B. Valuation Processing - Appraisal Scope-of-Work for Cooperatives. There can be great
19 variation in how a Cooperative is structured. According to the USPAP, the determination
20 of Scope-of-Work is an ongoing process in an assignment. Information or conditions
21 discovered during the course of an assignment may cause the appraiser to reconsider the
22 scope-of-work. Therefore, the guidance set forth below may be modified on a case-by-
23 case basis to assure compliance with USPAP and that the results of the appraisal
24 assignment will be reliable for making underwriting decisions. There are four major
25 elements for the appraisal assignment: General Requirements, Valuation as a Market
26 Rate Rental Project, Market Analysis for Continued Use as a Cooperative, and
27 Hypothetical Gross Sell-Out Value as a Cooperative.
- 28 1. General Requirements.
- 29 a. Selection of the Appraiser. The lender must select a qualified Appraiser in
30 accordance with Chapter 7. It should be noted that the appraisal of a Cooperative
31 is very specialized. Lenders should base their selection of an Appraiser on their
32 experience for this type of assignment and upon their familiarity with the
33 subject's market area.
- 34 b. Value Definition. Appraisers must use the following definition published by
35 Federal Regulatory agencies:
- 36 "Market value means the most probable price which a property should bring in a
37 competitive and open market under all conditions requisite to a fair sale, the buyer
38 and seller each acting prudently and knowledgeably, and assuming the price is not

1 affected by undue stimulus. Implicit in this definition is the consummation of a
2 sale as of a specified date and the passing of title from seller to buyer under
3 conditions whereby;

- 4 (1) buyer and seller are typically motivated;
5 (2) both parties are well informed or well advised and acting in what they
6 consider their own best interests;
7 (3) a reasonable time is allowed for exposure in the open market;
8 (4) payment is made in cash or by financial arrangements comparable thereto; and
9 (5) the price represents the normal consideration for the property sold unaffected
10 by special or creative financing or sales concessions granted by anyone
11 associated with the sale.”

12 The value shall be estimated assuming that all repairs have been completed as of
13 the date of the appraisal.

14 c. Inspection of the Subject and Comparables. The primary appraiser designated by
15 the lender and accepted by HUD must physically inspect the subject (both exterior
16 and interior) and all of the comparables used as part of the analysis and must sign
17 the Certification within the appraisal report and the supporting HUD forms.

18 (1) The primary appraiser must inspect at least one of each bedroom/unit type.
19 The total number of units inspected must equal or exceed 5% of the total
20 number of units for projects of up to 200 units, or 4% of the total number of
21 units/beds for projects greater than 200 units. If the characteristics and/or
22 condition of the subject indicate that a higher level of inspection is necessary,
23 it is the appraiser's responsibility to expand the scope of the work as is
24 necessitated by the observations made by the primary appraiser during the
25 inspection of the subject. This is especially important where the
26 improvements are high-rise structures whereby individual units within
27 demonstrate varying degrees of light and view qualities. If there are
28 hazardous conditions or other factors that preclude a thorough inspection of
29 the interior, the appraiser must clearly indicate these circumstances in the
30 appraisal report.

31 (2) Large Projects. For projects exceeding 500 units, the appraiser must consult
32 with the processing office to agree on a reasonable number of units to be
33 inspected. In addition, the appraiser may employ assistants to inspect
34 individual units. The purpose of allowing assistants is to encourage a
35 thorough inspection. The names and qualifications of these assistants must be
36 disclosed in the appraisal report but they are not required to sign the report.

37 (3) The primary appraiser must inspect all of the comparables used in deriving an
38 estimate of value, including land comparables (if applicable), improved

- 1 comparables sales, expense comparables and rental comparables. The
2 appraiser must verify the condition of the comparables at the time of
3 transfer/rental with management or other personnel familiar with the property.
4 Contact information must be documented in the appraisal report.
- 5 d. Required Appraisal Report Exhibits. In accordance with the requirements of
6 Chapter 7 and the programmatic requirements of Section 223(f).
- 7 e. Review of the PCNA and Phase I ESA. The appraiser must review the PCNA and
8 ESA prior to completing the assignment, comment on any remarkable findings
9 and their impact (if any) on value.
- 10 f. Required Approaches. In accordance with the requirements of Chapter 7 and the
11 programmatic requirements of Section 223(f).
- 12 g. Estimation of Remaining Economic Life (REL). In accordance with the
13 requirements of Chapter 7 and the programmatic requirements of Section 223(f).
- 14 h. HUD Forms. All of the usual forms for Section 223(f) should be employed,
15 (92264, 92264-A, 92273 and 92274) following the outstanding instructions for
16 Section 223(f). The Form HUD-92264 shall be completed based on usage as
17 rental apartments. The Gross Sell-Out Value should be summarized in Section
18 “O”; (Remarks).
- 19 i. Additional Appraisal Work Required by the lender or other Intended Users. The
20 appraiser is bound by USPAP to complete the appraisal assignment in compliance
21 with the requirements of the person or entity who ordered the report and to satisfy
22 the needs of identified intended users.
- 23 j. Reconciliation and Conclusion. The appraiser must briefly reconcile the
24 information presented; clearly indicating what data is the most relevant and
25 supports the report’s conclusions. The conclusions must indicate whether or not
26 the subject can expect to enjoy long-term use as a Cooperative; and whether or
27 not the proposed maintenance fee is within market limits and is affordable for the
28 typical shareholder.
- 29 k. Report Content and Format. In accordance with the requirements of Chapter 7.
- 30 2. Valuation as a Market Rate Rental Project. Follow all current procedures in Chapter
31 7 for Section 223(f) Appraisal and Appraisal Review, including these additional
32 instructions:
- 33 a. Use of the Subject. The appraiser shall assume a hypothetical use of the subject
34 as a market rate rental project, except that income from any units subject to rent
35 control will assume the current controlled rental amount.
- 36 b. Estimate of Effective Gross Income. The estimate of Effective Gross Income
37 shall be made using market rental housing comparables that are equivalent to the

1 subject in location, size and style. Actual rents should be used for any rented
2 units in the Cooperative that are subject to rent control. Market rents must be
3 used for any subsidized units. Vacancy and collection losses should also be
4 market derived, but in no event will a residential occupancy rate greater than 93%
5 and a commercial occupancy rate greater than 80% be used.

6 c. Expense Analysis. The Expense analysis should accurately reflect usage as a
7 market rate rental project. Appropriate weight should be given to the most recent
8 three year history for items such as repairs, maintenance and common utilities.
9 Other items such as taxes and management expense should be based on rental
10 apartment market data.

11 3. Market Analysis for Continued Use as a Cooperative. The appraisal report must also
12 contain a Level C Market Analysis of the local market with an emphasis on
13 Cooperatives. The purpose of the analysis is to determine the ability of the subject to
14 continue usage as a Cooperative Housing project. The detailed requirements for
15 performing a Level C analysis can be found in “Market Analysis for Real Estate”,
16 published by the Appraisal Institute. The study must also address these additional
17 requirements.

18 a. Assumptions. The study should assume that management has budgeting and
19 operations under control; which can be demonstrated by an illustration of past
20 years maintenance charge history.

21 b. Financial Statement Review. Special Assessments should be explained, and a
22 review of the last three years financial statements is required. (See Section
23 17.3.D.4 above for specifications for financial statements). The footnotes to the
24 Cooperative’s yearly financial statement are a typical source of details regarding
25 past, current and upcoming issues. There should be a discussion of any material
26 or atypical items as to their impact on value. In addition, the appraiser will
27 complete a Form HUD-92274 using comparable Cooperative projects and also
28 analyze the past three years records and any unaudited records from the most
29 current period, if deemed reliable, to ascertain if the proposed maintenance charge
30 is adequate to continue operations.

31 c. Cost of Occupancy/Cost of Ownership Analysis. The typical monthly
32 maintenance charge by unit type should be compared to the competing project’s
33 monthly maintenance charges by unit type and will serve as a variable for Cost-
34 of-Occupancy/Cost-of-Ownership calculations to ascertain and support market-
35 oriented unit pricing. The appraiser will complete a Form HUD-92273 for each
36 major Cooperative unit type using other units from other Cooperative projects as
37 comparables to compare monthly maintenance fees and to determine if the
38 proposed monthly fee is realistic and affordable for the subject’s market area.

39 4. Hypothetical Gross Sell-Out Value as a Cooperative. The appraiser will develop a

1 value estimate based on a Gross Sell-Out of all units, using comparable sales analysis
2 and any other industry acceptable methods, before the application of all costs and
3 entrepreneurial profit associated with a conversion from a rental property to a
4 cooperatively owned property and further assuming a vacant and moderately
5 renovated unit. Additionally, this value is over and above a pro rata share of an
6 underlying mortgage encumbering the premises. Based on the proposed mortgage
7 refinancing, it is considered that such debt conforms to the influencing market
8 parameters. A sample breakdown of the Gross Sell-Out Value is as follows:

Gross Sell-Out Value:	
Gross Sell-Out for Residential Units (453 Rooms x \$48,000/Rm)	\$21,744,000
Unpaid Balance of Underlying Mortgage	\$2,858,300
Total Gross Sell-Out Value and Underlying Mortgage	\$24,602,300
Rounded	\$24,600,000

9 5. Appraisal Review. HUD Multifamily Staff Appraisers will review the appraisal in
10 accordance with USPAP Standard 3. The appraisal review must include a
11 comparison of the subject's proposed monthly maintenance fees based on the new
12 financing to what the various units would rent for if the subject were operated as a
13 rental project. A Cooperative Housing project's feasibility for continued use as a
14 Cooperative is questionable if monthly maintenance fees significantly exceed what
15 units could actually rent for. A downward trend in rents versus no change or an
16 upward trend in maintenance fees is an indication of an unhealthy Cooperative
17 Housing project/market.

18 C. Environmental Processing. The HUD Review Appraiser will follow all applicable
19 instructions in Chapter 9.

20 D. Mortgage Credit Processing. Follow the current procedures in Chapter 8 for Section
21 223(f) modified as follows:

22 1. Determination of the Acceptability of the Cooperative Corporation.

23 a. BOD Performance History. In processing an application, the lender will take into
24 account the BOD's ability and willingness to manage the Cooperative within the
25 requirements of Section 223(f). The lender will also consider all applicable
26 requirements contained in Chapter 10, Management Analysis.

27 b. Ability to Close. It must be determined that the Cooperative organization has the
28 ability to close the transaction in a satisfactory manner and that the sum of the
29 monthly charges to members will be adequate to meet debt service and other
30 ownership expense. It must also be determined that the present members of the

- 1 Cooperative, as a group, have the ability to provide whatever additional funds
2 may be required to close the transaction.
- 3 c. Credit-Worthiness. It must also be determined that participants have not been
4 debarred or subject to a Limited Denial of Participation, and are otherwise
5 capable of meeting their ownership and management obligations. For the Single
6 Asset Borrower Entity, its Officers and BOD Members, and the Management
7 Agent, the review should include the following documents:
- 8 • HUD-92013 SUPPLEMENT
 - 9 • HUD-2530 / APPS Clearance
 - 10 • Verification of Deposits
- 11 d. Other Business Concerns. List of other business concerns, are required for the
12 Officers of the BOD.
- 13 e. Adequacy of Monthly/Annual Charges. The underwriter must ensure that the sum
14 of monthly charges, as listed on Cooperative Membership Exhibit, converted to
15 an annual basis, is sufficient to meet the HUD estimate of debt service,
16 Cooperative operating expenses, taxes, special assessments and ground rents, if
17 any, plus a general operating reserve of 3% of these items. In making these
18 determinations of allowances for accessory income (if any), the allowance shall
19 not exceed the Cooperative's estimate or the appraiser's estimate of accessory
20 income, whichever is the lesser. However, rental payables under duly executed
21 acceptable leases for commercial space on the premises shall be used in lieu of
22 estimates. These payables should be totaled to be sure all members have
23 assurance that the total membership has their required minimum equity
24 requirements. The HUD estimate of annual charges will include the following:
- 25 • Debt service payments.
 - 26 • Cooperative Operating Expenses, Reserve for Replacements, Taxes,
27 Special Assessments and Ground Rent, if any.
 - 28 • (Memorandum attached to Form HUD-92264). General Operating
29 Reserve of 3% of Sum of Above.
- 30 f. Review of the Cooperative's Procedure for Approving New Members. The
31 procedures employed by the Cooperative in approving new members
32 (cooperators) should be reviewed to ascertain if there is compliance with any
33 income requirements and credit scores as contained in the Cooperative's bylaws
34 or other related agreements. Individual files for anyone becoming a member in
35 the three month period immediately prior to the date the application for Firm
36 Commitment was submitted must also be reviewed by the HUD processing office.
- 37 g. Maintenance Charges. The Hub/PC must review the procedures employed by the

1 Cooperative in reviewing its budget, determining the adequacy of the carrying
2 charge and to its history of carrying charge increases. The Cooperative's Bylaws
3 or other appropriate organizational documents must contain a provision that
4 requires an annual increase in the carrying charge based on inflation, in order to
5 address increases in operating expenses. The total amount of the unpaid balance
6 (30 days or more) for carrying charges and special assessments as shown in the
7 rent roll must not exceed 5% of the gross annual income.

8 2. Determination of Total Debt Service, Cooperative Operating Expense and GOR.
9 Total Debt Service will be calculated by multiplying the amount of the mortgage by
10 the sum of initial curtail rate, interest rate and MIP. Cooperative Operating Expense
11 includes those operating expenses, reserve for replacements, taxes, special
12 assessments and ground rents, if any, which are the responsibility of the Cooperative
13 membership as a whole rather than of the individual members and will include the
14 cost of occupancy of the units assigned to employee use. The GOR is 3% of the sum
15 of the annual charges described above, and is accumulated as a special reserve in
16 order to meet possible contingencies.

17 3. Outstanding Debt. Past due accounts payable and outstanding project liabilities must
18 be cleared and released, or otherwise fully satisfied, prior to or at loan closing.
19 Examples of such items include deferred management fees, overdue utility bills or
20 real estate taxes, or trade payables. These items are not to be included in the eligible
21 debt basis.

22 2. Completion of the Form HUD-92264-A and Determining the Maximum Insurable
23 Mortgage. Pages 1-2 of the form HUD-92264-A shall be completed according to
24 existing instructions, modified as noted in Section 17.3.A.

25 E. Asset Management Processing. The application must include the applicants' management
26 plan, including training requirements, and a description of maintenance procedures and
27 management of the Reserve for Replacement funding and work items.

28 **17.5 Program Requirements – Issuance of Firm** 29 **Commitment and Loan Closing**

30 Follow Section 223(f) closing procedures in the Multifamily Closing Guide and contact the
31 Hub/PC for the FHA Required Closing Instruments, FHA Form No. 3257-B, set forth in
32 Handbook 4550.3, Appendix 3-10.

33 **NOTE: The MAP Forms contained in this Appendix that are used by lenders and by**
34 **HUD processing staff will be updated, revised and reissued in a Housing Notice after**
35 **the Department has completed work that is currently underway to streamline**
36 **application processing and program requirements. The Forms are otherwise**

1 *unchanged.*

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Chapter 18

Section 223(a)(7)

18.1 Purpose of Section 223(a)(7)

Section 223(a)(7) of the National Housing Act (NHA) permits refinancing of HUD-insured multifamily projects. Refinancing results in prepayment of the existing mortgage, endorsement of a new mortgage and assignment of a new project number. Refinancing through Section 223(a)(7) typically reduces project debt service and increases cash flow by lowering the interest rate of the mortgage and/or by extending the amortization period. The increased project cash flow benefits properties and owners and reduces risk to the FHA Insurance Fund.

Section 223(a)(7) is applicable only to certain mortgages currently insured by FHA, as described below, and to HUD-held loans on projects subject to the Multifamily Assistance Housing Reform Appropriations Act of 1997 (MAHRA). A mortgage refinanced pursuant to Section 223(a)(7) is insured under the same section of the NHA as was the mortgage originally insured under that section of the act, for example, Section 221(d)(4) or Section 223(f).

Section 223(a)(7) refinancing proceeds may be used to fund (a) the payoff of existing FHA-recognized indebtedness (b) the cost of refinancing, (c) the cost of critical and non-critical repairs (as described in the required Property Capital Needs Assessment), and (d) deposits to reserve for replacement accounts. By statute, equity take-outs are not permitted under Section 223(a)(7).

18.2 Consolidation of applicable guidance

This Chapter provides guidance on processing Section 223(a)(7) refinancing transactions for all currently insured multifamily properties. Programs administered by the Office of Healthcare Programs are not covered by this Chapter.

This Chapter consolidates portions of previously issued guidance and incorporates new guidance and practices. This Chapter updates and clarifies past guidance replacing applicable portions of the following documents:

- Handbook 4567.1, Refinancing of Insured Multifamily Projects Pursuant to Section 223(a)(7),

- 1 • Housing Notice 93-89, Expedited Section 223(a)(7) Processing Instructions,
- 2 • Mortgagee Letter 94-17, Refinancing of Insured Mortgages Pursuant to Section 223(a)(7)
- 3 of the National Housing Act – Questions and Answers, and
- 4 • Mortgagee Letter 2006-03, Refinancing of FHA Insured Multifamily Project Mortgages
- 5 Pursuant to Section 223(a)(7)

8 **18.3 Basic Program Requirements**

9
10 Standard Processing Time. In general Section 223(a)(7) transactions should be processed
11 expeditiously to reach a Firm Commitment decision within 30 calendar days of receipt of a
12 complete application.

13
14 A. Eligibility. These instructions apply to the refinancing of multifamily properties with full
15 insurance mortgages and previously coinsured mortgages converted to full insurance.
16 Mortgages excluded from these instructions are:

- 17 1. risk share mortgages,
- 18 2. co-insured mortgages, and
- 19 3. HUD-held mortgages (other than those subject to a debt restructuring under the
- 20 Multifamily Assisted Housing Reform and Affordability Act (MAHRA)).

21
22 B. Maximum mortgage. The mortgage may not exceed the lowest of the following:

- 23 1. The original principal amount of the existing insured mortgage that is to be
24 refinanced (or the sum of the original principal amount of all mortgages to be
25 refinanced if two or more mortgages are being refinanced).
- 26 2. The unpaid principal balance of the existing insured mortgage (or mortgages if
27 more than a single mortgage are being refinanced), plus a., b. and c. below:
 - 28 a. Loan closing charges, including the application fee, upfront Mortgage
29 Insurance Premium (MIP), financing fee, prepayment penalties associated
30 with the mortgage note, title and recording fees, and legal fees associated
31 with the refinancing, and required deposits to the reserve for replacements.
 - 32 (1) The allowable application fee is the amount anticipated to be paid
33 net of any post-closing refund.
 - 34 (2) The cost of defeasance of any existing bond issue and bond
35 discounts may not be included.
 - 36 (3) Discounts. The cost of any discounts may not be included in
37 estimating the maximum mortgage amount.
 - 38 b. Outstanding debt incurred in connection with capital improvements made
39 to the property that are acceptable to the Hub or Program Center.

1 Indebtedness incurred in connection with funding operating deficits,
2 deferred management fees or other non-capital costs (other than
3 Section 223(d) loans) are not eligible for inclusion in calculating the
4 maximum mortgage amount available for refinancing under Section
5 223(a)(7) nor are past-due payables. See Section 8.5.B.5 for a
6 discussion of clearing or resolving past-due payables at the time of
7 closing.

8 c. HUD-approved Critical and Non-critical repairs costs.

9 (1) Critical repairs must be completed prior to endorsement.

10 (2) Non-critical repairs may be deferred but should be completed
11 within twelve months of endorsement. For projects with relatively
12 limited scope and dollar cost of non-critical repairs, a 10% escrow
13 will be established, which may be funded with a letter of credit.
14 HUD may determine that a larger escrow is appropriate for
15 projects with more extensive repairs, or may waive the escrow for
16 very minor replacement cost items.

- 17
18 3. The amount that can be amortized by the applicable percentage described below
19 of the project's estimated net operating income. The mortgage may exceed this
20 amount by capitalizing the savings from any tax abatement that runs with the
21 land. Physical occupancy assumptions used in calculating the project's estimated
22 net operating income should be based on historical occupancy levels.

<u>Rent Structure</u>	<u>Required Debt Service Coverage Ratio (DSCR)</u>	<u>Form 92264- A Criterion 5 loan ratio</u>
Projects with >90% of units assisted by Project- Based Section 8, and Cooperative Housing insured under Section 213	1.05	95.0%
All other projects	1.11	90.0%

- 23
24 C. Mortgage term. The term of a new mortgage insured pursuant to Section 223(a)(7) may
25 be extended up to 12 years beyond the maturity date of the existing, originally insured
26 mortgage . The term cannot be extended beyond 75% of the remaining useful life of the
27 project or the maximum term permitted in the section of the act under which the existing
28 mortgage is insured. If the existing mortgage is the result of a previous refinancing
29 through Section 223(a)(7), the longest allowable maturity date of the new mortgage is 12
30 years beyond the maturity date of the mortgage originally insured under the FHA
31 insurance program but not to exceed 75% of remaining useful life.

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**Example of allowable term/maturity date extensions
for a Section 223(a)(7) refinancing
of a mortgage currently insured under Section 223(f)**

Assumptions			
Current loan program		Section 223(f)	
Maximum permitted term under the applicable program		35 years	
Assumed amortization start date		January 1, 2000	
Examples of permitted term/maturity extensions for loans of different initial terms			
	Maturity date (original term)	New maximum maturity date if refinanced under 223(a)(7) on January 1, 2010	New maximum maturity date if refinanced for a second time under 223(a)(7) on January 1, 2013
Loan 1	January 1, 2035 (35 years)	January 1, 2045 (any later maturity would violate the maximum 35-year term limit under the applicable SOA, in this case 223(f))	January 1, 2047 (any later maturity would violate the maximum 12-year extension of the original mortgage's term)
Loan 2	January 1, 2030 (30 years)	January 1, 2040 (any later maturity would exceed the 30-year term of the original mortgage)	January 1, 2042 (any later maturity would violate the maximum 12-year extension of the original mortgage's term)

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**Example of allowable term/maturity date extensions
for a Section 223(a)(7) refinancing
of a mortgage previously insured under Section 221(d)(4)**

Assumptions:			
Original loan program		Section 221(d)(4)	
Current loan program		Section 221(d)(4) or Section 223(f)	
Maximum permitted term under the applicable program		40 years or 35 years	
Assumed amortization start date		January 1, 2000	
Examples of permitted term/maturity extensions for loans with different refinancing histories			
	Maturity date (original term) as a Section 221(d)(4) project	New maximum maturity date if refinanced under 223(f) on January 1, 2010	New maximum maturity date if refinanced under 223(a)(7) on January 1, 2013
Loan 3	January 1, 2040 (40 years)	January 1, 2045 (the maximum 35-year term limit under the applicable SOA, in this case 223(f))	January 1, 2048 (any later maturity would violate the maximum 35-year term limit under the applicable SOA, in this case 223(f))
Loan 4	January 1, 2040 (40 years)	Not Applicable (No refinancing on this date)	January 1, 2052 (any later maturity would violate the maximum 12-year extension of the original mortgage's term)

If two or more existing FHA-insured multifamily loans are to be refinanced into a single Section 223(a)(7) loan, the term of the new Section 223(a)(7) mortgage may not exceed 12 years beyond the maturity date of the earliest-to-mature originally insured mortgage.

Any extension of the new mortgage term beyond the remaining term of the existing mortgage may not result in a mortgage term that exceeds 75% of the remaining useful life of the property.

- D. Mortgage Insurance Premium. At endorsement, the borrower must pay an upfront MIP of ½ percent (0.50%) of the mortgage amount. The mortgagee of record must submit Form HUD-9807, Request for Termination of Multifamily Mortgage Insurance, to obtain a refund for the borrower of a portion of the MIP paid pursuant to the original mortgage.

1 E. Environmental review requirements.

- 2 1. A Phase I Environmental Site Assessment is not required. Pursuant to 24 CFR
3 50.19(a)(21), there are no environmental review requirements and the form HUD
4 4128 “Environmental Assessment and Compliance Findings for the Related
5 Laws” does not have to be filled out. Transactions that require significant repairs
6 are not appropriate for processing under Section 223(a)(7).
7
8 2. Flood insurance. The lender must determine if the property is located in a special
9 flood hazard area (based upon the most recent Flood Hazard Map) per Section
10 9.5.E.1. If the site is determined to be in such an area, the borrower must obtain
and maintain Flood Insurance coverage for the duration of the mortgage.

11 F. Fees.

- 12 1. Application fee - The non-refundable application fee paid to HUD is 15 basis
13 points.
14
15 2. Maximum fees – Lenders may charge financing fees that may not exceed the
16 amounts below. Fees may be increased for bond transactions to cover fees
17 associated with costs of issuance. Legal fees paid by the lender are not included in
Lender Fees for purposes of the calculations below.

18

New Loan Amount	Maximum Lender Fees (not bond transactions)	Maximum Lender Fees (bond transactions)
Portion of loan amount above \$2,000,000	2.00%	4.00%
Loan amount up to \$2,000,000	3.50%	5.50%

- 19
20 3. Inspection fee - There is no inspection fee even if there are deferred non-critical
21 repairs.
22

23 G. Project Numbering. Projects will be assigned the next FHA number under the same
24 Section of the Act under which the project was originally insured.
25

26 H. Regulatory Agreement. A new Regulatory Agreement must be executed at closing under
27 the same Section of the Act as the original loan (including modifying the principal(s) in
28 provision 50). Amending and restating the existing Regulatory Agreement is not
29 permitted.
30

31 I. Cost Certification. Cost certification is not required. As a condition of the Firm
32 Commitment, HUD may require the borrower to produce information related to the cost

1 and completion of Critical and Non-critical repairs and to provide appropriate
2 documentation to HUD, including, at a minimum, invoices, receipts and photos, as repair
3 funds are drawn from escrows. The need for site visits in connection with the completion
4 of repairs or escrow draws will be determined by the Hub Director of the HUD office
5 with jurisdiction over the property. Projects with minor repairs typically would require
6 few, if any, site visits by HUD staff.

7
8 J. Commencement of Amortization. Amortization will begin on the first day of the second
9 month following the date of the initial/final endorsement of the mortgage note.

10
11 K. Source of Funds for Prepayment Penalty Costs.

- 12 1. Prepayment penalty costs are, as discussed in 18.3.B.2.a., eligible mortgageable
13 costs.
- 14 2. The one exception to the general prohibition that lenders may not pay or
15 otherwise provide funds for borrower costs in 223(a)(7) transactions is that
16 lenders may pay prepayment penalty costs from Trade Profit proceeds
17 (sometimes also referred to as “premium,” “trade premium,” or “marketing
18 gain”) on the sale of the GNMA or other mortgage-backed security.
- 19 3. The lender’s application must include a Sources and Uses statement specifying:
20 a. the amount of Trade Profit used to pay prepayment penalty costs, and if
21 the total prepayment penalty costs associated with the mortgage note(s) to
22 be repaid exceed such amount, the amount of prepayment penalty costs to
23 be paid from other sources, specifying such source(s);
24 b. the minor amounts of excess Trade Profit, if any, to either be deposited to
25 the replacement reserve or retained by the lender;
- 26 4. Trade Profit cannot be used to pay for repairs or costs other than Prepayment
27 penalty as noted above. The source of funds for repairs and transactions costs
28 must be accounted for separately in the project’s Sources and Uses statement.

29
30 L. Refinancing Partial Payment of Claim (PPC) Properties. A recast first mortgage loan and
31 an associated Partial Payment of Claim second mortgage may both be refinanced in a
32 Section 223(a)(7) transaction so long as the new loan amount does not exceed the original
33 principal amount (i.e., the original pre-Mark to Market restructuring loan amount) and it is
34 clear the market or project conditions have improved to the point there is little risk the
35 new loan will default.

- 36
37 1. HUD will require that the HUD-held second mortgage be (1) paid off in full; (2)
38 partially paid off; or (3) left in place. If partially paid off or left in place, HUD
39 will maintain the surplus cash split of 25% to owner and 75% to pay down the
40 HUD-held second (statutory under MAHRA). Pursuant to the owner paying
41 down (or paying off) the HUD second mortgage with available loan proceeds,

1 mortgage proceeds must first be allocated to fund the reserve for replacement
2 account (at a threshold of \$1000/unit) and make needed repairs to assure the
3 ongoing value and viability of the asset. HUD will consider modifying the
4 required 25-75% split, on a case by case basis (subject to MAHRA constraints)
5 where debt service savings will allow.

6 2. Upon refinance, debt service payments will not exceed what is currently in place.
7 Since these properties have previously undergone a PPC, HUD would not want
8 them encumbered with additional debt which could negatively affect future
9 financial stability. Consequently, the interest rate on the new mortgage must be
10 competitive enough such that substantive savings in debt service payments will
11 result.

12 3. The debt service coverage rate of 1.2 will be required to account for the additional
13 risk inherent with a former PPC.

14 Processing of such a transaction would follow the same procedure as that of other
15 multiple mortgages permitted to be wrapped into a single 223(a)(7) refinance transaction.
16 HUD regional or satellite office production staff should solicit particular input from asset
17 management staff on these transactions.

18 M. Commitment, Regulatory Agreement and Closing.

19 1. Commitment. The commitment should be in letter form listing the: a)
20 commitment amount, b) the Section of the Act with any appropriate further
21 reference, e.g., 223(a)(7) pursuant to 221(d)(4), c) loan terms and requirements, d)
22 any required repairs, e) the requirement for executing a new Regulatory
23 Agreement and f) the requirement that the owner notify OAMPO when any
24 repairs deferred until after endorsement are underway and/or completed.

25 2. The commitment is valid for a period of 90 days. It is not anticipated that
26 extensions will be necessary in a Section 223(a)(7) refinancing. However, the
27 Hub or PC Director may extend Section 223(a)(7) commitments for a maximum
28 of three additional 30-day periods, provided that processing and underwriting
29 conclusions are updated as necessary so they are current at the time of any
30 extension.

31 3. The commitment must require that the existing Reserve for Replacements be
32 transferred in total to the new mortgage, and specify the dollar amount of funds to
33 be transferred and the amount of additional replacement deposits.

34 4. Closing. Loans will be closed using standard closing procedures.
35

36 **18.4 Processing**

37
38 A. Section 223(a)(7) applications submitted by lenders approved to submit MAP
39 applications must be processed under MAP unless an identity of interest exists. If an
40 identity of interest exists between the lender and the borrower the application must be
41 submitted under TAP or through an alternative lender. FHA-approved multifamily
42 lenders who are not approved to submit MAP applications may submit Section 223(a)(7)

1 applications, but such applications must be submitted and processed as TAP loans.
2 B. Project Analysis. Lenders must provide an analysis with their applications which
3 provides details about the sizing of the Section 223(a)(7) mortgage consistent with this
4 guidance and a Sources and Uses statement consistent with such mortgage sizing
5 calculations. The following may serve as an example of the content and presentation of a
6 submitted Project Analysis:

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8
9

1 **The following is an example of a sample transaction – the data shown is for illustration**
2 **purposes only**

Section 223(a)(7) - Project Analysis - Mortgage Sizing and Sources and Uses Worksheet			
Project Name	Oak Tree Manor Apartments	Project #	123-45678
Project City, ST	Springfield, MO	Name of Mortgagor	Oak Tree Manor LP
Lender	FHA Capital Mortgage, Inc.		
I. Lowest Mortgage Amount of criteria		Requested Amount = Cost to Refinance Mtg	
Lowest Mortgage Amount of criteria		\$ 1,590,700	
1. Mortgage or Loan Amount Requested in Application	This is a manual input usually equal to the lowest of the three amounts below:		\$ 1,590,700
2. Original Principal Amount of Mortgage(s) to be refinanced	Difference vs. request	\$151,600	\$ 1,742,300 Highest
3. Amount Based on Debt Service Ratio (see calculation 3. details below)		\$2,700	\$ 1,593,400 Middle
4. Amount Based on the cost of refinancing (see calculation 4. details below)		\$0	\$ 1,590,700 Lowest
II. Total Requirements for Settlement			
Uses - Mortgageable Amounts			
Current Unpaid Principal Balance of Existing Debt	\$	1,303,275	
Total Prepayment Penalty Costs	\$	39,098	
HUD approved debt to refinance via the A7	\$	-	
Critical repairs	\$	5,000	
Non critical repairs	\$	14,500	
Initial dep to reserve for replacements	\$	211,083	
Fees	\$	-	
Financing fees (excluding Title&Rec., Leg&Org.)*	\$	41,358	
Title Recording	\$	8,000	
Legal & organizational	\$	10,000	
Other permitted costs	\$	-	
(a). Total Mortgageable Uses of Cash	\$	1,632,314	
Sources			
FHA Mortgage Amount	\$	1,590,700	
Trade Discount	\$	-	
Trade Profit to pay prepmt pnlt + any R4R dep	\$	-	Note: net proceeds to pay borrower costs: \$ 1,590,700
Grants & other sources to pay costs, e.g., debt	\$	-	
Purchased and Transferred Reserves	\$	41,518	
(b). Total Sources of Cash	\$	1,632,218	
Cash Requirement Calculation			
(c)=(a)-(b). Mortgageable Uses of cash less Sources	\$	96	
(d). Non-mortgageable: Assurance of Completion Escrow	\$	2,900	
(e)=(c)+(d). Total Cash required	\$	2,996	
III. Payback calculations & change in interest rate and maturity date			
	<u>P&I/mo.</u>		
Refinanced Debt***	\$10,926	Transaction costs	\$98,456
New Mortgage	\$8,388	Divided by Annual P&I savings	\$30,451
P&I savings (monthly)	\$2,538	Equals Payback Period (in years)	3.2
Annual P&I savings	\$30,451	New 223(a)(7) interest rate:	5.375%
		Old interest rate:	4.250%
		Interest Rate reduction:	1.125%
		Maturity extension (yrs.):	12.0

3

1 The following is an example of a sample transaction – the data shown is for illustration
2 purposes only

Project Name	Oak Tree Manor Apartments	Project #	123-45678
Project City, ST	Springfield, MO	Name of Mortgagor	Oak Tree Manor LP
Lender	FHA Capital Mortgage, Inc.		

3. Amount Based on Debt Service Ratio

a. Mortgage Interest Rate	4.250000%
b. Mortgage Insurance Premium Rate	0.450000%
c. Initial Curtail Rate	term assumed (mos.) 315 2.077766%
d. Sum of Above Rates	6.777766%
e. Net Income	\$ 120,000 x 90.0% = \$108,000
f. Annual Ground Rent	+ Annual Spec. Assmt. = \$108,000
g. Line e minus line f	\$108,000
h. Line g divided by line d	\$1,593,400
i. Annual Tax Abatement	divided by =
j. Line h plus line i	\$1,593,400

Note: rounding down amount: \$45

4. Amount Based on Existing Indebtedness, Repairs, and Loan Closing Charges*

To Calc max mortgage based on cost, follow the steps below:

First, list known costs:	calc'd as	Mortgage sizing	Interest Rate	Maturity date	Term	Princ. Bal date
Current Unpaid Principal Balance of Existing Debt	\$ 1,303,275	100.0%	5.375%	6/1/2026	171	3/1/2012
Total Prepayment Penalty Costs	\$ 39,098	3.0%				FHA# 123-45678
Prepmt pd via trade profit	\$ -					
R4R pd via trade profit	\$ -					
Tot borrower cost via trd prft	\$ -					
HUD approved debt to refinance via the A7	\$ -					
Amount required to pay off existing debt	\$1,342,373					
Critical repairs	\$ 5,000					
Non critical repairs	\$ 14,500					
Initial dep to reserve for replacements	\$ 211,083					
Fees	\$ -					
Title Recording	\$ 8,000					
Legal & organizational	\$ 10,000					
Other permitted costs	\$ -					
(a). Total known/fixed costs before other sources	\$ 1,590,956					
List known non FHA-loan sources that offset costs:						
Grants & other sources to pay costs, e.g., debt	\$ -					
Purchased and Transferred Reserves	\$ 41,518					
(b). Sum of known amounts to offset costs	\$41,518					
(c)=(a)-(b). Total known costs less known offset sources	\$1,549,438					
Second, list unknowns, i.e., costs as % of the final mortgage amount:						
FHA MIP	0.45%					
FHA exam	0.15%					
Financing Fee	0.50%					
Perm Placement fee	1.50%					
Allowance extra	0.00%					
Trade Discount	0.00%					
Total of unknowns %s	2.60%					
(d). 1 minus % sum above is the gross up factor	97.40%					
Third, apply gross up factor based on unknowns	97.40%					
(c)/(d). Calculated cost mortgage	\$ 1,590,799					
Calculated cost mortgage rounded down	\$ 1,590,700					

Note: Repairs Escrow calculations
 \$14,500 a. Non-critical repairs
 20.0% b. % escrow
 \$2,900 c. \$ escrow

Note: Total knowns excluding payoff
 \$ 248,583

← Monthly P&I = \$ -

← Should be equal

The figures below recategorize the figures above to show a traditional cost mortgage breakdown:

a. Total Existing Indebtedness	\$ 1,342,373
b. Required Repairs	\$ 19,500
c. Other Fees	\$ -
d. Loan Closing Charges ** (see details below)	\$ 270,441
e. Sum of line a through line d	\$1,632,314
f. Enter the Sum of any Grant/Loan and Reserves for Replacement and Major Movable Equipment on Deposit	\$41,518
g. Line e minus line f (rounded down)	\$1,590,700

Note: rounding down amount: \$96 consistency chk vs. M108 (should be \$0) 10

*Amounts included must reflect the applicant's expectations of costs, so that any anticipated change in costs, such as a policy-directed refund of fees, are taken into account.

Section 223a7 Mortgage Sizing and Sources and Uses worksheet 5-31-12.xlsx

1 The following is an example of a sample transaction – the data shown is for illustration
2 purposes only

Project Name	Oak Tree Manor Apartments	Project #	123-45678
Project City, ST	Springfield, MO	Name of Mortgage	Oak Tree Manor LP
Lender	FHA Capital Mortgage, Inc.		

V. Details of Pricing of the mortgage or a mortgage security reflecting any Trade Profit to be used for permitted borrower costs for Cost Based Criterion mortgage and Actual Mortgage (which may be equal to the Cost Based Criterion Mortgage if this is the maximum permitted mortgage):
Note: Allowed borrower costs from trade profit include only prepayment penalty costs and any ancillary deposit to the R4R.

Pricing before and lender retained trade profit based on % above and certain "knowns" per cost-based mortgage calc'd. in 4. above.			Pricing before and lender retained trade profit based on % above and certain "knowns" per actual mortgage		
	\$	% of msa amt. (par)		\$	% of msa amt. (par)
Principal amount of the mortgage	\$1,590,700	100.000%	Principal amount of the mortgage	\$1,590,700	100.000%
Prepmt pd via trade profit	\$0	0.000%	Prepmt pd via trade profit	\$ -	0.000%
R4R pd via trade profit	\$0	0.000%	R4R pd via trade profit	\$0	0.000%
Tot prds for borrower costs (excludes Escrow for Completion Assurance)	\$1,590,700	100.000%	Tot prds for borrower costs (excludes Escrow for Completion Assurance)	\$ 1,590,700	100.000%

VI. Financing Charge details for Cost Based Criterion mortgage and Actual Mortgage (which may be equal to the Cost Based Criterion Mortgage if this is the maximum permitted mortgage):

** Financing Charges based on % above and certain "knowns" per cost-based mortgage calc'd. in 4. above.		* Financing Charges based on % above and certain "knowns" per actual mortgage	
FHA MIP	\$ 7,158	FHA MIP	\$ 7,158
FHA exam	\$ 2,386	FHA exam	\$ 2,386
Financing Fee	\$ 7,954	Financing Fee	\$ 7,954
Perm Placement fee	\$ 23,861	Perm Placement fee	\$ 23,861
Allowance extra	\$ -	Allowance extra	\$ -
Discount	\$ -	Discount	\$ -
Trade Premium for prepmt costs,R4R	\$ -	Trade Premium for prepmt costs,R4R	\$ -
Title Recording HUD	\$ 8,000	Title Recording HUD	\$ 8,000
Legal & org	\$ 10,000	Legal & org	\$ 10,000
Initial dep to reserve	\$ 211,083	Initial dep to reserve	\$ 211,083
Total	\$ 270,441	Total	\$ 270,441

VII. Details of prepayment penalty and sources of payment

	\$	% of new actual mtg. amt.	*** If a refi of a refi, describe original mortgage here:
Total Prepayment Costs to be paid	\$39,098	2.458%	Original Princ. Balance Int. Rate
Total prepayment pnltly to be paid from mortgage proce	\$39,098	2.458%	Maturity date Term Amort. start date
Total prepayment pnltly to be paid from Trade Profit	\$0	0.000%	FHA #
Balance of Trade Profit to deposit into the Res. For Repl	\$0	0.000%	
Trade Profit Retained by the Lender			
Enter % here: <input type="text" value="0.000%"/> or total \$ here: <input type="text" value="\$0"/>	\$0	0.000%	
Total Trade Profit	\$0	0.000%	

Section 223#7 Mortgage Sizing and Sources and Uses worksheet 5-31-12.xlsx

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3 C. Verification of existing borrower debt. The lender must verify the amount and terms,
4 including prepayment penalties and repayment terms, of existing insured mortgage debts
5 and any other secured or unsecured debt of the borrower.
6 1. The application should include a copy of the mortgage note and documents
7 evidencing other indebtedness.
8 2. The lender should compare the mortgage debt information submitted to the lender
9 with information in the project’s financial statements and the title search report.
10 Any discrepancies should be explained in writing by the owner. Since the owner
11 is prohibited from encumbering the project without HUD’s written approval, if
12 the owner is in violation of this provision, the violation should be brought to the
13 attention of the Director of Asset Management in the Multifamily Program Center
14 with jurisdiction.
15 3. If the borrower has made advances (i.e., has debt from the project) to fund repairs
16 or betterments (whether or not evidenced on a HUD-approved promissory note), a
17 determination must be made as to whether the debt is acceptable to HUD. If the
18 debt is to be repaid as part of the 223(a)(7), it is not necessary for the debt to be
19 on a HUD-approved form prior to closing. If the debt is to remain in place after
20 closing to reduce cash requirements, the owner must evidence the debt on HUD-
21 approved forms.
22 4. When additional indebtedness is associated with betterments made to the project
23 and previously financed, the borrower must provide a list of betterments financed
24 by that indebtedness.
25
26 D. PCNA requirement. A Project Capital Needs Assessment (PCNA) is required for all
27 Section 223(a)(7) applications. For purposes of Section 223(a)(7) refinancings, an
28 existing PCNA may be accepted if it conforms with current guidance for acceptability of
29 PCNA’s. Unless superseded by more current guidance, for purposes of 223(a)(7), an
30 existing PCNA may be accepted on the condition that:
31 a. It is dated not more than 2 years prior to the date of the application;
32 b. The Hub’s Supervising Project Manager or Director approves the use of the
33 existing PCNA for purposes of the application;
34 c. The PCNA contents and scope substantially conform to the requirements of
35 current PCNA guidance;
36 d. The borrower and lender are required to provide a new PCNA not later than 10
37 years after the date of the PCNA accepted with the application.
38
39 E. Site visits. Site visits (by either the lender or HUD) are not generally required, although
40 in case of large or distressed loans regardless of size, a site visit by the lender (and/or
41 HUD staff) may be appropriate and necessary.
42
43 F. Section 202 mortgage refinancings. Section 202 projects which are refinanced with an

1 FHA-insured loan are exempt from Section 514(g) of MAHRA under Section 514(h)(2)
2 of that act, for as long as the first FHA refinance loan is outstanding. If that FHA loan is
3 subsequently again refinanced, (using Section 223(a)(7) for example), that Section 514(g)
4 exemption is no longer applicable. Thus, if the Section 8 rents were above market, a
5 reduction of rents to market at the expiration of the contract term is required, and the
6 underwriting of the new loan must reflect rent levels which change from current to
7 market rate in accordance with the expiration of the contract. Such projects must be sent
8 to the Office of Recapitalization for processing the rent reduction under the Mark to
9 Market program.

10
11 **Example of underwriting a Section 202 project exempt under MAHRA’s mark-to-**
12 **market provisions**

Assumptions:				
Original loan program			Section 202	
Examples of rent-setting requirements for loans with different refinancing histories				
	Refinanced into an insured FHA loan in accordance with MAHRA	Exempt from Section 514(g) rent adjustment?	Subsequently refinanced into an insured FHA loan in accordance with MAHRA	Exempt from Section 514(g) rent adjustment for underwriting/loan sizing under MAP?
Loan 1	Yes	Yes - Under Section 514(h)(2)	Yes	No - Section 514(h)(2) no longer applies; adjustments would apply at the HAP contract’s expiration

13
14 G. Ownership/Property Management Changes. The lender must verify that any changes in
15 ownership since the endorsement of the existing loan have been properly documented and
16 approved through submission of Form 2530. Section 223(a)(7) applications should not be
17 submitted until any required Forms 2530 have been processed.

18
19 H. Changes of ownership. Any changes of ownership are subject to Transfer of Physical
20 Assets (“TPA”) procedures and must be executed separately from 223(a)(7) transactions.
21 The borrower for the loan being refinanced must be the same borrower for the proposed
22 223(a)(7) loan.

23
24 **18.5 Application Requirements Checklist**

25
26 Checklist and Exhibits.

27 See Appendix for the Section 223(a)(7) Application Requirements Checklist.