CHAPTER 11. SECTION 312 LOAN ADMINISTRATION PROCESS

11-1. INTRODUCTION. HUD has entered into a contract with a computer firm to operate a funds disbursement process known as the Cash Management System. The Cash Management System is designed to minimize the interest costs to the Government of providing funds before they are needed by the borrower, and to provide more useful data to HUD and LPA's on these disbursements. A HUD Notice has been issued which outlines the procedures under this system. This notice is incorporated in this handbook by reference, as it may be revised from time to time.

11-2. ESTABLISHMENT OF ESCROW ACCOUNT. All localities participating in the Section 312 Program must establish a "rehabilitation escrow account" with a local financial institution into which funds from the U.S. Treasury will be electronically transferred and directly deposited. These accounts must allow the LPA to issue checks to payees promptly and allow LPA's to maintain a record of each payment. If additional private or public funds will be used to supplement a Section 312 loan, a separate escrow account must be maintained for those monies. There must be no combining of Section 312 rehabilitation funds with other private or public monies.

These accounts may be either interest bearing or non-interest bearing accounts. Some institutions will not charge service charges if the account is non-interest bearing. In other cases, the interest earned in an interest bearing account could be used by the LPA to offset the cost of service charges which might be associated with this account. Since drawdowns will be in the account for brief periods, it is not expected that significant interest will accrue. Any interest that does accrue and is not used for service charges must go to the borrower, unless the LPA and borrower otherwise agree in writing. Any service charges not offset by interest are the responsibility of the LPA and must not be passed through to the borrower.

11-3. NOTIFICATION REGARDING THE DESIGNATED FINANCIAL INSTITUTION. After the LPA has secured a financial institution for the Section 312 escrow account, it must follow procedures outlined in the Cash Management Notice to notify the Cash Management Contractor of its designated financial institution.

11-4. SELECTING AN LPA CONTACT PERSON AND ALTERNATE. Each participating LPA must designate a contact person and one alternate to be the only

individuals authorized to interact with the Cash Management System. Refer to the Cash Management Notice for instructions for designating such people. It is incumbent upon each LPA to ensure that the contact person and alternate authorized to request funds do not share their ID's and passwords with each other, or with any

other person and that as personnel changes occur, HUD is promptly notified in order to invalidate ID's and Passwords.

A breach in the security system by LPA staff which results in a loss to the Government may result in prosecution under applicable Federal law, and conviction may result in fine or other penalty as appropriate.

11-5. SUPPLEMENTAL FINANCING. Supplemental financing supplied by the Borrower or another lender or grantor must be used prior to the use of Section 312 funds, or in equal proportion to the Section 312 disbursements. See Paragraph 9-3-i of this Handbook for requirements for handling supplemental financing, and Paragraph 7-5-d-(3) of this Handbook for information on acceptable forms of supplemental financing.

11-6. DISBURSEMENTS

a. General. Disbursements from the rehabilitation escrow account must be made according to the procedures outlined in the Cash Management Notice, and Chapter 10 of this Handbook, to the extent payment for rehabilitation construction is involved.

b. Disbursement in Case of Default. If the LPA becomes aware of any default under the terms of the security instrument or Rehabilitation Loan Agreement, the LPA must contact the HUD Field Office for advice as to whether remaining loan funds may be disbursed, or whether the loan must be declared in default, or whether other action must be taken. The HUD Field Office must consult with HUD Headquarters Office of Urban Rehabilitation concerning the resolution of these cases.

11-7. DRAWDOWN REQUESTS. There are three types of drawdown requests under the Cash management System: (1) Prior to settlement, (2) Interim Construction Draws, and (3) Final Closeout of Construction. Each drawdown requires the submission of certain documentation to validate the draw. Procedures outlined in the Cash Management Notice must be followed in making any drawdown request.

11-8. CALCULATION OF ACCRUED INTEREST ON LOAN ADVANCES. Interest will be accrued each month by the Cash Management contractor during the construction periods through to the Amortization-Effective Date (AED) at the applicable interest rate for the particular loan. This accrued

interest will be automatically deducted from the balance of the obligated loan amount, and added to the principal amount due on the loan, thereby decreasing the amount available for disbursement. See Paragraph 7-3-b of this Handbook for additional information on calculating the accrued construction interest, and the Cash Management Notice for more specific information on accrued construction interest.

11-9. COST OVERRUNS

a. Overruns in Rehabilitation Costs. If the rehabilitation costs are greater than anticipated, and if the scope of work cannot be decreased, additional funds should be obtained in accordance with Paragraphs 10-7-b and 10-13. If the scope of work cannot be reduced and the necessary additional funds cannot be secured within a reasonable period of time, the LPA must contact the HUD Field Office for advice as to whether remaining loan funds may be disbursed, or whether the loan must be declared in default, or whether other action must be taken. The HUD Field Office must consult with HUD Headquarters Office of Urban Rehabilitation concerning the resolution of these cases.

b. Overruns in Construction Interest. It is assumed that all Section 312 Loans are underwritten to include an estimation of the amount of interest which will accrue during the construction period, from the first drawdown through to the AED. Where the estimation is incorrect, the contingency set aside for accrued construction interest may be exceeded, and the remaining loan balance may be insufficient to meet all construction costs plus accrued interest. In such case, there are two options: The borrower may make up the shortfall in the funds available by paying the contractor from the borrower's own funds or the LPA may make up the difference from local funds (if they are available for such purpose). At each drawdown request, the Cash Management Contractor will determine whether there are sufficient funds in the account to cover accrued interest to AED if the drawdown is allowed. If there will not be sufficient funds, the request may be denied. If the LPA or HUD determine at any time that there will not be sufficient funds to cover the accrued construction period interest, the AED may be accelerated in order to reduce the amount of the accrued construction period interest, if the borrower agrees. Such changes in the AED must be submitted to the HUD Headquarters Office of Urban Rehabilitation for prior approval in accordance with Paragraph 9-2-a-(2)-(b), and if the AED is accelerated in this way, the note must be modified appropriately and must be approved by HUD Field Office Counsel. This action will require that the loan begin amortizing and that the borrower begin making payments of principal and interest and other payment requirements prior to the initially agreed-upon date.

c. Exceptions in Extraordinary Instances. In extraordinary cases, the Office of Urban Rehabilitation in HUD Headquarters may approve providing the borrower with additional Section 312 funds to provide additional funds for construction. See Paragraph 9-9 for requirements concerning this.

11-10. DISPOSITION OF FUNDS STATEMENT. After all funds have been disbursed

from the rehabilitation escrow account, the LPA must prepare a Disposition of Funds Statement (see Guideform in Exhibit 11-1) in which the LPA must account for the disposition of the full Section 312 Loan amount and any other funds used for the rehabilitation by the borrower. The Disposition of Funds statement must be signed by the borrower.

11-11. UNUTILIZED FUNDS. If there are any unutilized funds remaining under the approved loan after the final drawdown, the Office of Urban Rehabilitation in HUD Headquarters will notify the RAD to deobligate the remaining balance by a Notice of Deobligation. The borrower will only be required to repay Section 312 Loan principal to the extent that funds have been drawn down through the Cash Management System on behalf of the borrower. In such cases, it is the policy in the Section 312 program not to decrease the monthly payment without specific approval from HUD Headquarters. Rather, the normal procedure is to shorten the term of the loan. The actual sum disbursed will be reflected on the Disposition of Funds Statement (see Paragraph 11-10). If the borrower specifically requests, the original Promissory Note may be modified to reflect the reduced principal and shortened term of the loan, in addition to having the actual amount disbursed stated in the Disposition of Funds Statement given to the borrower. This portion of the Note (see last sentence in Sample Note, Exhibit 9-1) may not be completed by the LPA since the original Note should have been forwarded to the Master Servicer in the post-settlement transmittal of original documents (see Paragraph 9-4-c-(1)). Therefore, the LPA should notify the Master Servicer, which will fill in the correct figures, have an authorized program official at HUD Headquarters execute the original document, and then send a copy of the newly revised Note to the borrower.

11-12. CLOSEOUT REQUIREMENTS. The LPA must prepare and transmit to HUD's servicing agent, certain documentation, including the Disposition of Funds Statement described in Paragraph 11-10, in order to fully close out a loan, for servicing, as described in the Cash Management Notice.

11-13. TRANSFER FOR SERVICING. Once the Amortization Effective Date is reached, the Cash Management Contractor will transfer the loan to the Master Servicer for servicing. The Servicer will set up the account, assign a nine-digit account number, and issue the first bill to the

borrower prior to the date of first payment. The LPA still must provide the borrower with the due date and the amount of each payment, including tax and insurance escrow if applicable, and the monthly risk premium. The borrower must be advised to remit the first payment when due, even if a bill is not received prior to that date or risk being charged a late fee.

11-14. ADJUSTMENT OF THE AMORTIZATION EFFECTIVE DATE (AED). See Paragraph 9-2-a-(2) of this Handbook and the Cash Management Notice for

additional information in setting and changing AED's.

11-15. RECONCILIATION OF LPA REHABILITATION ESCROW ACCOUNT ACTIVITY. The LPA must receive a monthly statement from its designated financial institution which must include the cancelled checks. The LPA should, on a monthly basis, account for all checks included in the bank statement and reconcile the statement following the procedures as outlined in the Cash Management Notice.

11-16. FUND ACCOUNTABILITY. The Secretary and the Comptroller General of the United States and their designees, must have access, for the purpose of audit and examination, to the books, documents, and records of the locality or its agent or contractor, related to the administration of the Section 312 Loan program. Records must be retained for the life of the loan or for such shorter period as may be required by HUD regulations governing records disposition.