

CHAPTER 6. DEALING WITH PRE-CONSTRUCTION AND CONTRACT ISSUES

6-1. INTRODUCTION. The next step in processing a Section 312 Rehabilitation Loan deals with the construction and contract issues that arise prior to loan settlement and actual construction. It includes material on finding good contractors, adopting Local Rehabilitation Standards and rehabilitation specifications, inspecting the property and preparing a deficiency report and/or a work write-up, obtaining cost estimates, securing contractors' bids or proposals, developing contract documents, and dealing with prospective borrowers who want to act as their own general contractor.

The pre-construction and contract issues listed above are among the most important in the review process because the best way to avoid disputes between borrowers and rehabilitation contractors -- one of the most common forms of consumer complaints -- is to be extremely attentive to these issues. But they are also very difficult to administer because there is a great deal of room for subjective judgements.

The pre-construction review procedures described in this Chapter are designed to meet the following objectives:

- o To ensure that all deficiencies of Local Rehabilitation Standards are corrected in properties being rehabilitated with Section 312 Loan funds, and that the rehabilitation meets all other Federal requirements, including handicapped accessibility requirements, historic preservation and environmental standards, cost effective energy conservation standards, and lead-based paint hazard requirements;
- o To ensure that the proposed work is of a sufficiently high standard and that, after the completion of rehabilitation, the property will be in good and readily maintainable condition, at least for the term of the Section 312 Loan;
- o To ensure that the proposed rehabilitation costs are fair and reasonable;
- o To ensure that contractors are qualified to do the required work, and that qualified small, minority and women's businesses are afforded the opportunity and encouraged to participate in the Section 312 program.

It is important to note two additional points. First, the requirements of this Chapter apply to all projects that are funded totally or partially with Section 312 Loans. For Section 312 projects that are funded with other public or private sector sources, the Section 312

program pre-construction and contract requirements apply to the entire rehabilitation project.

Second, it must always be kept in mind that the contract for rehabilitation work between the borrower and a contractor is a private contract for the rehabilitation of a borrower's private property. Although the source of funding for the rehabilitation is (in whole or part) a Federal loan, HUD is not a party to the construction contract, and HUD accepts no legal responsibility to the borrower for the quality of the rehabilitation work performed by the contractor. While HUD imposes a number of terms and conditions on Section 312 Loans, both to meet specific requirements and for the Government's protection as lender, it is primarily the borrower's legal responsibility to meet these conditions, rather than HUD's responsibility to see that they are met. Although HUD mandates that the LPA undertake certain functions in the processing, settlement and disbursement of Section 312 Loans, and for related construction management, HUD does so for the financial benefit of the Government, and in furtherance of national program objectives, and not for the direct benefit of the individual borrower. HUD also accepts no legal responsibility to the borrower to supervise the LPA in performing these functions, and HUD regards the LPA as an independent contractor, rather than as HUD's agent, in performing these functions. (This does not mean that HUD forgoes the right to take programmatic, corrective or remedial action against an LPA which violates the program's requirements.) HUD's legal duty to the borrower in connection with a Section 312 Loan is limited to the disbursement of funds to the rehabilitation escrow account for the loan, and to take any other actions necessary to comply with HUD's duties under the legal documents governing the loan.

LPA's must decide what role to play in assisting borrowers to process and settle Section 312 Loans and to manage construction, beyond the specific duties of the LPA described in this Handbook. Many LPA's choose to provide considerable technical assistance to borrowers to complete the rehabilitation work in order to help protect the Government's and/or borrowers' interests. When providing this assistance to borrowers, LPA's may be implicitly accepting some legal responsibility for problems that may arise, depending on state law. As a result, LPA's should carefully review the statements made by their staff to prospective borrowers, as well their legal agreements with borrowers, to ensure that they are not taking on more legal responsibility than they are willing to accept.

- 6-2. IDENTIFYING QUALIFIED CONTRACTORS. This Paragraph sets forth HUD's minimum qualifications for contractors, which HUD sets forth for the benefit of the Federal government. The borrower may impose additional qualifications, as may the LPA. However, qualifications imposed by the borrower or LPA must not unreasonably narrow the range of bidders or violate applicable Federal anti-discriminatory laws, executive orders of

regulations. (See Chapter 12 for additional information on these Federal requirements.)

- a. Eligibility Requirements For Contractors. All contractors participating in the program, except for those meeting the requirements of Paragraph 6-7 concerning borrowers who act as their own contractor, must meet the following qualifications:
- (1) Recognized General Contractor. The contractor must be in business as a general contractor with a recognized performance record, unless the proposed rehabilitation work does not require more than two trades. In addition the contractor must be legally able to enter into a contractor with the borrower to undertake rehabilitation work.
 - (2) Licensing. The general contractor and all subcontractors must have all the necessary state and local licenses.
 - (3) Performance Bonds or Pledges of Assets. For all Section 312 Rehabilitation Loans in excess of \$100,000, the contractor must secure a full payment and performance bond for the total cost of rehabilitation prior to the commencement of work, or if the HUD Field Office Director of Community Planning and Development specifically approves on a case-by-case basis, the LPA may accept, in lieu of a bond, other firm guarantees of completion which involve a pledge of assets for at least ten percent (10%) of the total cost of rehabilitation. The pledged asset must either be an irrevocable letter of credit or some other pledge of liquid assets. The LPA should have an attorney review these pledges of assets to ensure that they can readily be enforced if necessary to complete the project.
 - (4) Other Insurance Requirements. The contractor must have, prior to the commencement of work, adequate worker's compensation, public liability insurance and property damage insurance.
 - (5) Not Temporarily or Permanently Suspended. The contractor must not be on HUD's debarred list or be temporarily or permanently suspended or debarred by the LPA because of poor past performance. (See Paragraph 6-2-d for additional requirements concerning LPA debarring.) The contractor must also not be on the U.S, General Services Administration's Consolidated List of Debarred, Suspended or Ineligible Contractors.
 - (6) Other Standards Established by the LPA. The LPA may want to establish other minimum standards, such as requiring contractors to submit a financial statement, or having the LPA check their credit report, record of complaints with the Better Business Bureau, work quality references from former customers, or credit references from suppliers, so long as these additional standards

are consistent with local law and Federal equal opportunity requirements, and do not unreasonably narrow the range of competition for, or increase the cost of, Section 312 work.

See Exhibit 6-1 for a sample form LPA's can use to verify contractors' qualifications, called "Prospective Bidders' Proof of Responsibilities."

b. Encouraging Participation by Small, Local Contractors and Minority and Women-Owned Businesses. The LPA must encourage small, local contractors and socially and economically disadvantage contractors, including contracting forms owned by women or minorities, to participate in the Section 312 Rehabilitation Loan Program. For this purpose, HUD is adopting the requirements of OMB Circular A-102, Attachment O, Paragraphs 9(a) and (b), which require that Federal grant recipients take affirmative steps to assure that small, minority and women's business enterprises are utilized, when possible, as sources of supplies, equipment, construction and services, and which encourage agencies to apply these standards to loan programs to the extent practical. See Paragraph 12-7 of this Handbook for additional information. The LPA may also want to refer minority and women-owned businesses to the Small Business Administration (SBA) and to local Minority Enterprise Small Business Investment Corporations (MESBIC's). (MESBIC's are local, non-profit minority associations funded by the U.S. Department of Commerce to provide seed money to new and expanding minority businesses.)

c. Developing a List of Eligible Contractors

(1) Rules Governing a List of Contractors. The LPA may develop a list of eligible contractors if they so desire. However, the LPA cannot refuse to award a contract merely because a contractor is not on the list; the contractor's eligibility can be established after the submission of a bid or proposal, so long as an eligibility determination is made prior to loan approval.

(2) Advantages and Disadvantages. The advantages of an LPA's developing a list of eligible contractors are that the LPA can have a ready list of contractors who meet the program's qualifications and are interested in working with the program. The disadvantages are that, by having a list, the LPA may give prospective borrowers the mistaken impression the contractors on the list are recommended and guaranteed by the LPA, and that no other contractors are eligible to participate in the program. In addition, if LPA's develop a list, they must maintain the list and ensure the contractors with unsatisfactory performance are deleted.

8/13/86

6-4

7375.01 REV-2

(3) Developing a List. The LPA can advertise in local newspapers, radio and television stations, and place signs

where contractors do business, such as suppliers' shops. Whenever appropriate, and in the interest of attracting minority and women contractors, the LPA should advertise in minority newspapers, radio and television stations or hold workshops with minority groups and women's business organizations to explain the program. In order to generate the greatest possible response, the LPA should consider holding a meeting or workshop for local contractors, possibly in conjunction with a local association of builders or contractors, to explain the program and requirements governing bidders (see Paragraph 6-2-a) and dispel any misconceptions. The LPA could also contact local Minority Enterprise Small Business Investment Corporations for additional information on local minority businesses.

- d. LPA Debarment. Whether or not the LPA decides to maintain a list of eligible contractors, they must monitor the work of contractors who perform under the Section 312 program, and establish written procedures for suspending and debarring contractors from participating in the program for unacceptable performance.

6-3. ADOPTING LOCAL REHABILITATION STANDARDS AND SPECIFICATIONS

- a. Introduction. One of the first steps the LPA must deal with in relation to rehabilitation pre-construction issues is deciding what level of rehabilitation to require and adopting corresponding rehabilitation standards and specifications. Localities may use models adopted by their state, other states or national standards, such as The Rehabilitation Guidelines (written by the National Institute of Building Sciences and published by HUD in 1980), so long as these standards comply with applicable laws. It is most important that the locality carefully consider its rehabilitation needs and objectives and that some standard be clearly specified and adopted by the locality. Specific information about rehabilitation standards and rehabilitation specifications is detailed below.

- b. Local Rehabilitation Standards

- (1) General Requirements. For the purposes of meeting the requirements of the Section 312 Program, any rehabilitation code or standard legally applicable to the entire locality or the area in which the subject property is located is acceptable to HUD. (See Paragraph 6-3-b-(3) concerning Housing Assistance Plan requirements.) If no standards are adopted by the locality, the Housing Quality Standards, established under the HUD Section 8 Existing Housing Program (24 CFR 882.109), become the Local Rehabilitation Standard.

- (2) Cost Effective Energy Standards. Local Rehabilitation Standards must also meet the minimum requirements of the Cost Effective Energy Standards, established under 24 CFR 39, whether the locality has adopted its own codes or standards,

or uses the Housing Quality Standards.

- (3) Meeting Housing Assistance Plan Goals. If a locality want to have Section 312-assisted units meet housing assistance goals set forth in the locality's Housing Assistance Plan, the Section 312 units must meet the minimum requirements of the Section 8 Existing Housing Quality Standards (24 CFR 882.109) after rehabilitation, whether or not they meet state and local codes.

c. Rehabilitation Specifications and Performance Standards. In identifying and describing the work to be included in a Section 312-assisted project, the LPA must use either rehabilitation specifications or performance standards, and these must be included in all work write-ups, whether prepared by the LPA, the contractor, or some other outside party. Specifications and performance standards are each described below.

- (1) Specifications. Specifications are detailed descriptions of required work items for properties undergoing rehabilitation in the locality. They give detailed information on the types, quantities, and qualities of materials and fixtures, including trade name and number, where applicable, detailed instructions or proper techniques for repair or replacement of items, and descriptions of any special conditions which may be pertinent.
- (2) Performance Standards. Performance standards, unlike detailed specifications, focus on the end result rather than describing the specific materials and techniques to be used. General practices or standards published by trade associations provide information on the minimum acceptable practices and workmanship of the various trades, and types and qualities of materials, fixtures and equipment. When performance standards are used, they should be identified by a specific trade association standard wherever possible. Using performance standards allows contractors to use their own discretion and specifications, so long as they meet these minimum qualitative standards.
- (3) Specifications vs. Performance Standards. The LPA may use either specifications or performance standards in their work write-ups, and there are pros and cons for each. Using detailed specifications gives the LPA somewhat more control over the rehabilitation work. Using performance standards, on the other hand, allows contractors to use more discretion in solving construction problems on their own while still requiring that minimum quality standards be maintained.

8/13/86

6-6

7375.01 REV-2

- (4) Rehabilitation Specification Book or Performance Manual. Each LPA must adopt a Rehabilitation Specification Book or Performance Manual; the pre-approved nature of the book or

manual greatly simplifies and expedites the preparation of write-ups. The specification book or performance manual must be developed specifically for rehabilitation. The book or manual must be made available to contractors working with the LPA.

- d. Additional Information. For additional information on preparing and adopting rehabilitation standards or a specification book or performance manual, the LPA should consider coordinating with other local code and inspection agencies, such as local building, housing and health code officials, as well as with the Rehabilitation Management Specialist in the local HUD Field Office.

6-4. INSPECTING THE PROPERTY -- IDENTIFYING PROBLEMS THAT SHOULD BE REPAIRED.

The next step is inspecting the property. The Paragraph deals with the minimum requirements concerning inspecting properties on which Section 312 Loans are being requested and with reporting on deficiencies with a deficiency report and/or a work write-up.

- a. Minimum Requirements for all Properties -- One Inspection. The LPA must make at least one inspection of the property to identify all deficiencies which must be corrected to meet Local Rehabilitation Standards and other Federal requirements, including handicapped and accessibility requirements, historic preservation and environmental standards, and lead-based paint hazard requirements. In connection with this inspection or separately, the LPA must also make an initial check of the property to determine if there appears to be any termite infestation or damage. If the LPA determines as part of its initial inspection of the property that it is possible that the property has termite infestation, but that the LPA staff is not qualified to properly inspect the property for termite damage, the LPA must obtain a termite inspection of the property from an outside termite inspection or extermination company. (See Paragraph 3-1-b-(4)-(e) for additional requirements concerning termite inspections, and Chapter 12 for additional information about the other Federal requirements.) If someone other than an LPA prepares the work write-up, the LPA must also verify, in an on-site inspection, that the work write-up meets the requirements of Paragraph 6-4-b-(2). The LPA must also ensure that the proposed rehabilitation costs are fair and reasonable in order to protect the Federal government's interests in the property, in accordance with the requirements of Paragraph 6-5 of this Handbook.
- b. Reporting on Deficiencies. One or both of the following techniques must be utilized to report deficiencies of the property:

- (1) Deficiency Report. The LPA may prepare a deficiency report, noting all required items, as well as any incipient deficiencies, recommended General Property Improvements and

other recommended actions. A deficiency report does not include proposed solutions to the deficiencies (which must be included in a work write-up). If contractors are the only parties preparing work write-ups for the property, then a deficiency report must be prepared by the LPA or by an independent third party.

(2) Work Write-Up

- (a) General Requirements. A work write-up is a listing of all deficiencies in the property, but also includes proposed solutions, such as "Repair 1" x 1" hole in living room wall -- fill with spackling compound, sand smooth and seal before painting." Work write-ups must be prepared for all Section 312 Loans. If contractors are the only parties preparing work write-ups pursuant to this Paragraph 6-4-b, their work write-ups must be included in the contractors' proposals prepared in accordance with Paragraph 6-5-b. If the work write-up is prepared by the LPA or an independent third party, the write-up must be incorporated by reference in the contractors' proposals. If someone other than the LPA prepares the work write-up, the LPA must verify, in an on-site inspection, that the work write-up meets the requirements of this Paragraph 6-4-b-(2). The prospective borrower must review and approve the work write-up, and he or she must sign and date it.
- (b) Requirements of Work Write-Ups. A work write-up prepared in accordance with this Paragraph must meet the following standards:
- 1 The work write-up must be either a written description of each work item to be performed under the rehabilitation contract, or architectural plans with written specifications as needed. The write-up must reference the locality's specifications or performance standards.
 - 2 If must include all work necessary to correct deficiencies of Local Rehabilitation Standards and to meet other Federal requirements, as well as any other work being done to correct incipient deficiencies and to undertake general property improvements. (General Property Improvements are permitted only if all deficiencies of Local Rehabilitation Standards and other Federal requirements are met. See Chapter 3 for

- 3 It must include all work to be done on the property as part of the rehabilitation project, whether financed with Section 312 funds or supplementary funding.
 - 4 It must be precise and detailed enough to remove all reasonable doubt as to the location, nature, method and extent of work to be performed, and to permit the LPA and contractors to estimate costs for each work item.
- (c) Parties Eligible to Prepare Work Write-Ups. Work write-ups done in accordance with this Chapter must be prepared by one of the following:
- 1 The Contractor. There are definite advantages to having the contractor develop his or her own write-up based upon a deficiency report prepared by the LPA staff as part of its required inspection: there are often several ways to solve a construction problem, and contractors often prefer to use their own solutions to the LPA-identified problems. In addition, the LPA can save administrative costs if they do not need to retain their own staff to develop work write-ups. However, when contractors prepare their own write-ups, their bid proposals may include slightly different work components, and it could be difficult to compare proposals against one another. In addition, the LPA needs to ensure that any write-up prepared by a contractor adequately addresses and meets all other applicable Federal requirements, and that the work write-up meets all the other requirements of this Handbook.
 - 2 An Independent Third Party -- A Professional Architect or Engineer or a Building Inspection Firm. A professional architect or engineer or building inspection firm may prepare a work write-up if properly licensed to perform such services in the jurisdiction. The cost for these professional services is an eligible loan cost, pursuant to Chapter 3.
 - 3 LPA. The LPA staff may prepare the work write-up if, in the opinion of the Loan Approving Officer, they are qualified to do so.

6-5. INSURING THAT REHABILITATION COSTS ARE FAIR AND REASONABLE -- COST ESTIMATES AND BIDS/PROPOSALS. The next key step in dealing with pre-construction and contract issues is ensuring that rehabilitation costs are fair and reasonable. The Paragraph deals with the requirements governing cost estimates done by persons other than the contractor and with the requirements for securing contractor bids or

proposals. These requirements are designed for the benefit of the Federal government by helping ensure that loan funds are used efficiently and that value is added to the secured property.

a. Cost Estimates

- (1) Guidelines for Cost Estimates. A cost estimate is an estimate of rehabilitation costs, done on an item-by-item basis. The estimated cost may be listed on the work write-up sheet beside each work item, but the estimated costs must not be shown to the contractor if the cost estimate is prepared by the LPA or an independent third party. The cost estimate should be compared with the prospective borrower's level of affordability calculated in accordance with Paragraph 4-7; if the prospective borrower cannot afford the monthly payments that would be required to do all the work listed in the cost estimate, supplemental financing must be arranged or general property improvements or other non-required work items must be eliminated from the scope of work or the loan must be denied.
- (2) Requirements. The LPA must review the costs of rehabilitation work for all Section 312 Loans to ensure that the proposed contract price is neither grossly excessive nor grossly inadequate, and that sufficient funds will be available from all sources to complete the work. In order to determine whether the proposed rehabilitation costs are fair and reasonable, the LPA should prepare or have an independent third party prepare a cost estimate based on the work write-up prepared pursuant to Paragraph 6-4-b-(2) of this Handbook. If a cost estimate is prepared by the LPA or an independent third party, the LPA may not permit prospective borrowers to accept a bid that exceeds the total cost estimate by more than fifteen percent (15%) of the total cost estimate. In addition, the LPA may not permit prospective borrowers to accept bids that the LPA determines to be grossly inadequate since underbid projects can often result in poor or incomplete work and eventual default by the borrower.
- (3) Requirements for Section 312 Loans Over \$33,500. For Section 312 Rehabilitation Loans over \$33,500, an independent cost estimate must be prepared. The cost estimate must be prepared either by a staff member of the LPA who has the necessary qualifications and experience to do so, or by an independent consultant, such as a professional cost estimator, architect,

8/13/86

6-10

7375.01 REV-2

engineer or building inspection firm with the necessary qualifications and experience in conduction cost estimates. The cost of outside, professional cost estimating services may be included in Section 312 Loan. For the purposes of

this Section, contractors who have any interest in the loan, including prospective borrowers who themselves are professional contractors, may not prepare these independent cost estimates.

- (4) Requirements for Section 312 Loans of \$33,500 or Less. For Section 312 Loans of \$33,500 or less, cost estimates may be prepared by contractors who have an interest in the loan, so long as the LPA complies with the minimum inspection requirements of Paragraph 6-4-a of this Handbook. If the contractor is the only one preparing a cost estimate, the following must occur: (1) the contractor must submit an itemized cost estimate along with his or her proposal, and (2) an independent consultant or staff member of the LPA who has the necessary qualifications and experience to conduct cost estimates must conduct a detailed review of contractors' cost estimates, based on published cost standards and/or their knowledge of the building trades, and must certify that the proposed costs are within fifteen percent (15%) of these established standards. However, it is recommended that the LPA obtain an independent cost estimate for these loans as well. Again, the cost of professional, outside, cost estimating services may be included in a Section 312 Loan.

b. Bidding Requirements

- (1) General Bidding Requirements. The LPA must encourage competition among contractors working on the Section 312 Program to help ensure that rehabilitation costs are fair and reasonable, and that the proposed work is of a sufficiently high standard. It is also important to note that, regardless of the method used to choose a contractor, the borrower has ultimate responsibility for the final selection. As a result, while the LPA must be available to provide technical assistance to borrowers, the borrower has the right and responsibility to choose the contractor of his or her choice, so long as the other requirements of the Section 312 Program are met.
- (2) Options For Meeting Bid Requirements for Section 312 Loans of \$100,000 or Less. LPA's are required to strongly encourage each prospective borrower, regardless of the size of the Section 312 Loan, to obtain proposals or bids from more than one contractor. It may be the cause of an audit finding against an LPA if it is determined that borrowers are frequently selecting contractors without obtaining more than one bid. Given this requirement, the LPA may utilize any of the following techniques to obtain bids or proposals from contractors for Section 312

- (a) Negotiation. Prospective borrowers may utilize negotiation to select a contractor and an acceptable price for some or all Section 312 Loans of \$100,000 or less. The prospective borrower is strongly encouraged, although not required in every instance, to negotiate with more than one contractor. In any event, the LPA must verify that the price is fair and reasonable, and the LPA must comply with the requirements detailed in Paragraph 6-5-b-(1) above. Where the contractor prepares the work write-up, the bids may be for slightly different scopes of work, and the prospective borrower must decide which proposal best meets his or her needs and desires, based on the cost and work proposed.
- (b) Informal Bidding. The LPA and prospective borrowers may also utilize an informal bid procedure for some or all Section 312 Loans of \$100,000 or less. It is suggested that LPA's using informal bidding use bid procedures similar to those for formal bidding detailed in Paragraph 6-5-b-(2)-(c), but this is not required. For instance, an LPA may elect to follow all the formal bidding procedures, except that instead of using formal advertising described in Paragraph 6-5-b-(2)-(c)-1, the LPA could choose to send letters to several contractors notifying them that they can pick up bid packages at the LPA's office if they are interested in bidding on the job. Whatever informal bid procedures they decide to use, the LPA must detail these in writing and make them generally available to contractors.
- (c) Formal Competitive Bidding. The LPA may choose to use formal competitive bidding for some or all of their Section 312 Loans of \$100,000 or less. When the LPA decides to utilize formal competitive bidding, the process must be administered in accordance with written procedures established by the LPA. The procedures must include at least the following:
- 1 The LPA must publish an invitation for sealed bids in a local newspaper having general circulation in the locality. The advertisement must contain at least the following:
 - o address of property to rehabilitated;
 - o where and when bid documents can be obtained;
 - o date of site review, if any;

- o date, time and place for bid submission;

- o date and time of bid opening.

See Exhibit 6-2 for a Request for Bids Guideform.

- 2 Work Write-Ups. Bidders must be provided with a deficiency list, and/or with a work write-up if prepare by someone other than the contractors, and the contractors must have access to the LPA Specification Book or Performance Manual, from which they must prepare their bid.
- 3 Two Bids. The LPA must make every attempt to obtain at least two bids prior to the bid opening. The bid submission deadline may be extended if only one bid is received in order to allow bidders more time to submit bids, so long as the contractor who submitted the one bid is so informed and has the right to submit an adjusted bid before the new deadline. If at least two bids are still not received, the single bid may be opened and recorded, and, if acceptable to both the LPA and the prospective borrower, it may be accepted and properly documented in the file.
- 4 Sealed Bids. The LPA must hold a bid opening, and when opened, the bids must be read aloud and recorded. At least fifteen (15) calendar days must be allowed between the appearance of the advertisement and the bid opening date, although the LPA should consider extending this time period for larger rehabilitation projects.
- 5 Review Bids With Prospective Borrower. The LPA must show prospective borrowers the total cost submitted by each bidder, and the LPA should assist the prospective borrower to decide which bid to accept. See Exhibit 6-3 for a Compilation of Bids Guideform which can help the LPA summarize bids received.
- 6 Low Bid. It is recommended that the low bid be accepted, unless the LPA and the prospective borrower decide that the low bidder is not likely to be able to adequately complete the improvements for the bid price, or if the low bidder is otherwise not eligible to participate in the Section 312 Program. (See Paragraph 6-2 of this Handbook for additional information on eligible contractors.)

- (3) Requirement for Section 312 Loans Greater Than \$100,000. Formal competitive bidding, pursuant to Paragraph 6-5-b-(2)-(c) of this Handbook, is generally required for all Section 312 Loans exceeding \$100,000. However, the HUD Field Office Manager may approve an LPA's request not to utilize competitive bidding when the Section 312 Loan exceeds

\$100,000, but only if all of the following three conditions are met: (1) the owner must have a preferred contractor who meets minimum qualifications detailed in Paragraph 6-2 of this Handbook, (2) the proposed construction price must be within ten percent (10%) of the cost estimate prepared by the LPA or by an independent third party, and (3) it can clearly be demonstrated that formal, competitive bidding would be unreasonable and/or unproductive. An LPA requesting approval from the HUD Field Office Manager to not utilize formal, competitive bidding must make such request in writing to the Field Office Manager, stating the reasons for the request and demonstrating that the above three conditions are met. The Field Office Manager must respond in writing, and a copy of both the request and reply must be included in the loan file.

- 6-6. DEVELOPING A CONSTRUCTION CONTRACT. The next step in the process is developing a construction contract between the borrower and the contractor. (The relationship between the borrower and HUD is controlled by the loan documents prescribed by HUD, as detailed in Paragraph 9-3.)
- a. Importance of Carefully Preparing Contract Documents. The rehabilitation contract is critically important because it protects the rights of the borrower, contractor, LPA and HUD, and details the responsibilities of each. It also defines the procedures for resolving any disputes that may arise. It must also contain certain Federally-mandated provisions and must otherwise be consistent with state law. In order to adequately protect and detail all rights and responsibilities and comply with applicable law, including local law which differs greatly state-by-state, LPA's are encouraged to consult with an attorney familiar with rehabilitation contracts in their state in developing the contract documents. LPA's in smaller localities may want to consider the possibility of coordinating with other neighboring localities to secure an attorney's services and develop contract documents.
 - b. No Collusive Arrangements. The LPA must establish procedures to ensure that there is no opportunity for or appearance of collusive arrangements, including fraudulent or deceitful arrangement between contractors and subcontractors, between the LPA and contractors, and between contractors and borrowers.

8/13/86

6-14

7375.01 REV-2

- c. The Contract Between the Borrower and the Contractor
 - (1) General Requirements. The borrower and the contractor are the sole parties to the rehabilitation contract. HUD assumes no legal liability or responsibility to the borrower for the performance of any term of the contract, and the LPA should also not accept any responsibility to the borrower for the performance of the contract, except for acting as escrow agent for the disbursement of funds after inspecting the work

performed under the contract. (See Paragraph 6-1 of this Handbook for additional information on HUD responsibilities.) The LPA, however, must approve each Section 312-assisted rehabilitation contract. Section 312 rehabilitation contracts must include the following:

- (a) A detailed description of the rehabilitation work to be performed, including work being financed with Section 312 funds as well as from other sources (The Work Write-Up and Cost Estimate Guideform, Exhibit 6-4, may be used for this purpose.);
 - (b) The agreed-upon price;
 - (c) The times within which performance and payment are required (See Paragraph 10-2 for details on when work can begin);
 - (d) Other provisions necessary to describe the responsibilities of the borrower and the contractor, including the contractor's one year warranty (See Paragraph 10-10);
 - (e) All provisions necessary to comply with Federal laws and regulations governing Section 312 construction contracts, including Federal labor standards provisions where required (See Paragraph 12-13 and Exhibit 12-11).
 - * (f) A provision requiring that the contractor's books and records related to the Section 312 Program be made available, at any time during normal business hours, to the Secretary or the Comptroller General or their designees to inspect, copy, and audit. *
- (2) Developing Procedures for Resolving Disputes. The rehabilitation contract must also include provisions for resolving any disputes that may arise between the borrower and the contractor, such as disagreements over the quality of work or changes to the contract. The LPA should consider whether or not to require that all unresolved disputes be submitted to mediation or binding arbitration (See Paragraph 10-11).

6-7. DEALING WITH BORROWERS WHO WANT TO ACT AS THEIR OWN CONTRACTOR.

- a. General Requirements. Rehabilitation work may be undertaken by the borrower on any eligible property by using his/her own labor; by acting as general contractor and supervising the hiring and work of all subcontractors; by performing some of the work himself/herself; or by some combination of these methods.

There are many advantages to having a qualified borrower act as his or her own general contractor. Substantial cost savings can

be achieved, and a borrower/contractor has a greater incentive to assure that work is done well. However, only a very few borrowers are qualified to act as their own general contractor, and when not properly qualified, borrower/contractors can cause substantial problems for themselves and for the security of the loan. Borrower/contractors must meet all of the following requirements:

- (1) Have adequate knowledge and experience doing rehabilitation work and/or subcontracting;
- (2) Have adequate time to supervise the job;
- (3) Have adequate working capital to be able to pay suppliers and subcontractors, who generally require payment as work is carried out, before Section 312 Loan funds are released, which is generally after work on specific components has been completed.

The LPA must establish procedures to ensure that there is no opportunity for or appearance of collusive arrangements, including fraudulent or deceitful arrangements between the borrower, subcontractors and/or the LPA.

All borrowers who want to act as their own general contractor must obtain approval from the LPA, which may deny the request based either on the borrower's failure to meet the requirements in Paragraph 6-7-a-(1) through 6-7-a-(3) above, or on the LPA's lack of available staff to provide adequate technical assistance to the borrower.

b. Approval of Disbursements. Where a borrower elects to perform work on his/her own property as the general contractor, the borrower is not required to approve loan disbursements under Chapter 10, and invoices must be submitted to the LPA for approval.

c. Non-Professional Contractors

- (1) Self-Help Agreement. The LPA must execute a written Self-Help Agreement with borrowers who are not professional contractors, and the agreement must contain the following:
 - (a) The specifications and scope of work to be done by the borrower and by subcontractors;

8/13/86

6-16

7375.01 REV-2

- (b) A definite time schedule for completion of each item of work to be done by the borrower and each subcontractor;
- (c) Alternate means of accomplishing the work if the borrower is unable to do so;
- (d) Written contracts with each subcontractor containing the provisions required by Paragraphs 6-6-a through 6-6-c of

this Handbook, and a method of selecting and managing subcontractors;

- (e) Costs for materials and equipment to be used by the borrower;
 - (f) A provision requiring that loan disbursements for the borrower's specified materials and equipment may be made only after acceptable installation. During the progress of the work of each subcontractor, ten percent (10%) of the applicable payment must be retained. Subsequently, upon satisfactory completion of an individual subcontract, the entire loan amount due for that subcontract may be released except where state or local law provides otherwise.
 - (g) Provisions necessary to comply with applicable Federal, state and local requirements;
 - (h) Procedures for resolving disputes between the borrower and subcontractors, and the LPA and the borrower, including sanctions to be applied if the work is not completed properly or is unduly delayed.
- (2) Eligible Rehabilitation Costs. These are limited to the following:
- (a) Subcontracts -- the actual cost of material, labor, and reasonable profit and overhead for subcontractors;
 - (b) Suppliers -- fixed price for supply contracts;
 - (c) Borrower's Portion -- the actual cost of materials, rental or purchase of equipment, and the actual cost of insurance premiums to provide coverage as required by the LPA, but excluding any funds to pay the borrower or family members residing in the same household for their labor or for profit or for overhead as general contractor.

d. Professional Contractors

- (1) Applicability. This Section applies to borrower/contractors who otherwise meet all the eligibility requirements for contractors in Paragraph 6-2 of this Handbook.

- (2) Self-Help Agreement. The LPA must develop a Self-Help Agreement to be executed between the LPA and the professional contractor/borrower. The Agreement must include, at a minimum, all provisions required by Paragraph 6-7-c of this Handbook. All other requirements in this Chapter, except for competitive bidding, are applicable to the Agreement.

- (3) Eligible Rehabilitation Costs. Eligible costs for borrowers who are professional contractors and function in that capacity in relation to the Section 312 Loan are limited to the following:
- (a) Subcontracts -- the cost of material, labor reasonable profit, and overhead for subcontractors;
 - (b) Suppliers -- fixed price for supply contracts;
 - (c) Borrower
 - 1 the actual cost of laborers hired by the borrower, so long as they are not members of the borrower's family residing in the same household;
 - 2 the actual cost of materials;
 - 3 an allowance for the borrower/professional contractor's overhead, which cannot exceed ten percent (10%) of the following: the total cost of subcontractors, plus the cost of materials and labor for work to be performed by the borrower/contractor's employees. (This does not in any way imply that "cost plus" contracts are permitted for borrower/professional contractors. The contract with the borrower/professional contractor must be a fixed price contract, but it may include an item for contractor's overhead as part of that fixed price.) It is important to note that no item may be funded with Section 312 funds unless the cost is reasonable, in accordance with the requirements detailed in Paragraph 6-5 of this Handbook.
- e. Timing of Commencement of Work. Rehabilitation work must not start until the Section 312 Rehabilitation Loan is properly settled and the security instrument is recorded and, in the event the Truth-in-Lending period applies (see Paragraph 9-2-d of this Handbook) not until its expiration. See the Cash Management Notice for additional requirements concerning the commencement of work.