

## PREAMBLE TO CHAPTER 6.

The purpose of Chapter 6 is to provide a methodology and format that will result in the settlement of HDG projects in accordance with the requirements of Section 17(d) of the United States Housing Act of 1937 (the Act) and 24 CFR Part 850. Following the steps provided in the handbook, the final maximum grant, any amounts owed by the owner or grantee and the means by which to secure repayment will be determined. The requirements of the Act and the regulation as they relate to Chapter 6 are highlighted below.

References: A copy of Section 17(d) of the United States Housing Act of 1937, 24 CFR Part 850 (Appendix 14 of this Handbook), OMB Circular A-87 (Appendix 15 of this Handbook) and 4 CFR 101-105 (Appendix 16 of this Handbook), are included at the end of the handbook for further clarification.

The maximum amount of grant permissible is restricted by statute (Section 17(d)(4)(B) and (d)(9) of the Act), and regulation (24 CFR Part 850.61). The amount of a housing development grant... may not exceed that which will provide decent...housing of modest design that is affordable for families and individuals without other reasonable and affordable housing alternatives in the private market. (24 CFR Part 850.61(b)).

The grantee must refund to HUD any cash advanced in excess of the final grant amount, as shown on the certificate of completion approved by HUD. (24 CFR 805.79(d) and 105).

Section 17(d)(7) of the Act requires the grantee to take legal action to enforce owner compliance with the requirements. 24 CFR 850.101 specifies required grantee performance.

If the grantee fails to demonstrate to HUD's satisfaction that it has met the requirements of the Grant Agreement, HUD will take corrective action. The owner and grantee must enter into an Owner-Grantee agreement which requires the grantee to monitor and take action to enforce compliance by the owner. (24 CFR 850.103 and 151).

The owner's equity must be reasonable. (24 CFR Part 850.37). A developer's fee may not be considered in the grant amount, project costs or owner's equity requirement. However, they may be included in a loan secured by the project if the lender is a State housing finance agency, or the loan is funded by bonds issued by a State housing finance agency or similar local entity. The amount of any developer's fee shall not be counted in calculating the maximum grant amount. When HUD makes a determination that the grant has been disbursed to the grantee for ineligible uses, HUD will follow procedures in the Federal Claims Collection Standards (4 CFR Parts 101-105), 24 CFR 850.107.

- (a) Purpose. Project settlement occurs after the Housing Development Grant (HDG) project development activities have been concluded. A separate settlement process must be completed for each HDG project. The settlement process involves a final determination of HDG program eligible costs incurred by the project during construction or rehabilitation. The determination of costs, along with information on the sources of funds used to pay for these costs, is used to:
- (1) Measure whether each participating party, particularly the owner, has made all contributions required by the Grant Agreement; and,
  - (2) Determine if excessive HDG funds have been drawn. Examples of possible outcomes of the project settlement process include: a requirement that the owner increase the equity contribution to conform with the Grant Agreement; repayment of HDG funds by the grantee to HUD pursuant to a grant reduction; or, a release of HDG funds to the project which the grantee held back pending cost certification.
- (b) Process. The basic steps to the project settlement process are as follows:
- (1) The grantee shall notify the HUD state/area office when the project is ready for settlement by submitting a certification in the format of form HUD-90024, (Appendix 7 of this Handbook). Based upon satisfactory review of its own records, the HUD state/area office shall authorize the initiation of project settlement.
  - (2) The grantee obtains a Certification of Costs and Sources of Financing from the owner. Since the grantee is held accountable for this certification, HUD strongly recommends that the grantee require that the owner's cost certification be audited by a certified or independent public accountant.
  - (3) The grantee evaluates the owner's Certification of Costs and Sources of Financing for reasonableness, for compliance with the Grant Agreement and program cost eligibility standards, and for consistency with the grantee's own records.
  - (4) Within 90 days of HUD's authorization to initiate project settlement, the grantee prepares and submits to the HUD state/area office, a project settlement submission consisting of:

6-1

- (i) Determination of Project Costs (Appendix 8, form HUD-90025):
- (ii) Determination of Grant Amount and Equity

Investment (form HUD-90026, Appendix 9 of this Handbook);

- (iii)a Certification of Settlement Findings (form HUD-90027, Appendix 10 of this Handbook); and
  - (iv) documentation for the grantee's determinations. This documentation includes the owner's Certification of Costs and Sources of Financing.
- (5) The HUD state/area office reviews the Project settlement Submission. A letter of findings is prepared and sent to the grantee within 45 days of receipt of the grantee's Project Settlement Submission.
  - (6) The grantee shall provide a written response to all HUD findings within 30 days of receipt of the letter from the HUD state/area office. Any HUD response must be processed within 10 days of receipt of the grantee's response.
  - (7) After resolving all findings, the HUD state/area office prepares an HDG Settlement Agreement (form HUD-90028, Appendix 11 of this Handbook). The Settlement Agreement does the following:
    - (i) Specifies actions necessary to bring development funding levels from each participating party in compliance with the Grant Agreement.
    - (ii) Requires enforcement for the Project Term of all remaining requirements of the Grant Agreement, e.g., lower income occupancy, formula rents, ownership composition, operating subsidy continuance, and grantee monitoring.
  - (8) The state/area office Housing Director or state/area office Multifamily Division Director executes three originals of the HDG Settlement Agreement on behalf of HUD after which the HUD executed originals are transmitted to the grantee for execution by its Chief Executive Officer (CEO) or designee. The grantee maintains one original executed document and transmits one to the HUD state/area office and one to HUD Headquarters.
- (c) Organization of these Procedures: This chapter is divided into eleven paragraphs. After the overview, each remaining part is

function described. Paragraph 6-2 provides instructions on "Initiation of Project Settlement" for the grantee. Paragraph 6-3 prescribes "Certification of Costs and Sources of Financing by Owner." Paragraph 6-4 describes procedures for "Grantee Review and Project Settlement Submission." Paragraph 6-5 provides "Recommended Audit Guidelines for Owner's Cost Certification" for grantees, owners, and auditors. Paragraph 6-6 sets forth HUD "state/area office review" procedures. Paragraph 6-7 describes the "HUD-Grantee Settlement Agreement." Paragraph 6-8 describes the responsibilities of state/area offices to execute settlement. Paragraph 6-9 describes the Department's authority and provides a strategy to bring grantees and owners to settlement. Paragraph 6-10 presents the strategy for inducing grantee repayment of excess drawdowns.

For a full understanding of project settlement, all participants are urged to read the procedures in their entirety.

## 6-2. INITIATION OF PROJECT SETTLEMENT

- (a) Timing of Initiation of Settlement. The process begins when the grantee notifies HUD that the project is ready for settlement. The grantee shall notify the HUD state/area office immediately when all of the following have occurred:
  - (1) Construction/rehabilitation is complete and any certificate(s) of occupancy have been issued.
  - (2) All development and settlement costs have been incurred; that is, all goods and services have been received or contract work has been performed.
  - (3) If an Assisted Rental Payment (ARP) Account, Project Investment Account, (PIA) or lump sum disbursement is provided for in the Grant Agreement, the HDG funds have been drawn down, invested and placed in use for the purpose specified in the approved Investment Plan and the Grant Agreement. Further, an updated version of the Investment Plan and amended Trust Agreement must be on file with HUD reflecting the actual investment instruments, interest rates and projections.
  - (4) The last required Grantee Progress Report, and any updates thereto, has been submitted to HUD.
  - (5) The grantee has performed and is performing, or has delegated to a third party, all responsibilities specified in the standard provisions of the Grant Agreement, including but

compliance with the Owner/Grantee Agreement.

- (b) Grantee Transmission of Notification of Settlement to HUD. The grantee submits to the HUD state/area office a Form HUD-90024, Certification of Readiness to Initiate Project Settlement (Appendix 7 of this handbook) indicating that the actions in paragraph 6-2(a) above, have been accomplished. HUD will review its monitoring records to determine that these actions have been completed to the extent verifiable, and provide written authorization to the grantee to initiate project settlement.
- (c) Grantee Accountability for Expeditious Initiation of Settlement. HUD holds the grantee responsible for the expeditious completion by all parties of the actions in paragraph 6-2(a) above, and for prompt submission of the Certification of Readiness to Initiate Project Settlement after the conditions have been met. The grantee must monitor for potential delays in project settlement, e.g., failure by the owner to seek certificates of occupancy when work has been completed, from the time the project approaches substantial development completion.

In the event HUD monitoring identifies inordinate delays, HUD will notify the grantee that unless project settlement initiates and/or concludes within a reasonable interval, the grantee will be found in noncompliance with HDG program requirements. (Continued noncompliance by the grantee may affect its ability to compete in future HUD program competitions.) HUD may also respond to noncompliance by assuming all grantee project settlement responsibilities.

### 6-3. CERTIFICATION OF COSTS AND SOURCES OF FINANCING BY OWNER

- (a) Overview. Upon HUD authorization of project settlement, the grantee obtains from the owner: (1) a certification of project costs, and (2) a certification of the sources of all financing for the project, i.e., Certification of Costs and Sources of Financing. The certification of costs must be audited if required by the grantee, lender or mortgage insurer. If issues arise during the grantee or HUD review, the owner may be required to submit additional documentation of its costs and/or sources of financing.
- (b) Timing. The owner must submit a Certification of Costs and Sources of Financing on or before the date required by the grantee, but no later than 48 days after HUD authorizes the grantee to initiate project settlement.
- (c) Certification of Costs. The owner's cost certification must, at a minimum address all line items identified in form HUD-90031,

Sections G and J. The cost certification may be provided in the format of form HUD-90025 (Appendix 8 of this handbook) at the owner's option. If the owner chooses to use the format, complete only the column marked "Costs Provided by Owner." Such costs will include all outlays and contributions (after deduction of all kickbacks, rebates, adjustments, discounts and promotional or advertising recoupment made or to be made to the owner) which are eligible and reasonable.

Cost eligibility will be determined in accordance with the Attachment to form HUD-90025. Cost line items prohibited by the Attachment, but included in the latest HUD-approved form 90031 (incorporated in the Grant Agreement as amended), are eligible for reasonable amounts expended up to the amount approved.

In addition to meeting standards for cost eligibility referenced above, certified costs must also be reasonable. See Section 2.01 of Article II of the HDG Grant Agreement. The owner must provide an explanation to demonstrate the reasonableness of any line items which either vary by more than ten percent from the amount included or do not appear in the approved HUD Form-90031. In addition, the owner should be aware that, even if a line item is within ten percent of the approved amount, information available to the grantee or HUD subsequent to the date of the approved 90031 may result in a determination that costs are unreasonable.

The owner may be required by HUD or the grantee to provide documentation to support any costs in question. Such documentation must be provided on request.

Either the grantee, lender or mortgage insurer will in most instances require the owner to have its cost certification audited. Paragraph 6-5 of this handbook provides guidelines for audited cost certification for non-insured HDG projects. Projects with a mortgage insured or coinsured under the National Housing Act must comply with the cost certification procedures required by the applicable mortgage insurance program and must also comply with HDG project settlement procedures. The same audited cost certification may be used for both programs; however, the audited cost calculations required for mortgage insurance must be supplemented by an addendum showing differences in cost eligibility criteria between the HDG and mortgage insurance programs, e.g., differences in allowances for land value, legal and organizational costs, financing costs, builder sponsor non-cash equity, and funds expended for working capital or operating deficits. Cost certifications performed in accordance with another lender's guidelines must be similarly adjusted.

document the owner shall itemize the sources and amounts provided by each source for all funds which were used to pay for HDG Program eligible costs included in the owner's certification. In addition, the owner must indicate any long term operating subsidy mechanisms which have been established for the project including: an HDG Project Investment Account (PIA); a PIA funded by the owner, grantee, or bond proceeds; a periodic interest subsidy; or a project based rent subsidy from any public source.

The grantee may question the owner or appropriate funding source concerning amounts committed in the Grant Agreement but not included in the owner's certification. The grantee may also require a current title report to identify all project lienholders and the amount of secured debt.

The owner is held responsible for obtaining any grants or debt financing included in the Grant Agreement and the Owner/Grantee agreement. If operating subsidies committed by a source other than HDG are not needed to maintain project feasibility or to provide tenant subsidies required by the Grant Agreement, the owner must explain in its submission.

#### 6-4. GRANTEE REVIEW AND PROJECT SETTLEMENT SUBMISSION

- (a) Overview. The grantee shall evaluate the owner's Certification of Costs and Sources of Financing for accuracy, necessity, reasonableness, and cost eligibility, and makes its own determination of project costs, appropriateness of the HDG amount disbursed, and compliance by all participating parties with Grant Agreement funding commitments. These determinations are provided to HUD as a "Project Settlement Submission" described in paragraph G below.

The grantee is held accountable for project costs and source of financing information used in its Project Settlement Submission. Inaccurate or incomplete information may result in a HUD determination that the grantee is in default of the Grant Agreement, required to repay some portion of the HDG, and/or subject to penalty under Law. To prevent such a determination, HUD strongly encourages the grantee to require an audit of the owner's certification of costs, and as needed, to require further documentation of financing sources. HUD reserves the right at any time to examine all project records and to request additional documentation as necessary for this settlement or resolution of HDG program audit findings by the HUD Inspector General or under the Single Audit Act.

Recommended guidelines for grantee mandated audits of owner cost certifications are described in Paragraph 6-5 of these procedures. The cost of such an audit may be

included in the costs for determining the HDG amount.

- (b) Timing. The grantee must transmit a fully assembled Project Settlement Submission to the HUD state/area office within 90 days of HUD approval to initiate project settlement.
- (c) Grantee Determination of Project Costs. The grantee or its designee (agent, auditor or entity under contract to the grantee not affiliated with the owner) must complete form HUD-90025, Determination of Project Costs (Appendix 8 of this Handbook). Unless otherwise noted in the instructions to this form, the column entitled "Approved HUD-90031" must be completed using the Exhibit M-1 incorporated in the Grant Agreement as most recently amended. Revisions to the HUD-90031 are noted in Exhibit A of the Grant Agreement and any amendments thereto. If the grantee is not in possession of the most recently approved HUD-90031, it should contact HDG Program staff at HUD Headquarters.

The "Actual Cost Provided By Grantee" column should include all outlays and contributions (after deduction of all kickbacks, rebates, adjustments, discounts and promotional or advertising recoupment made or to be made to the owner). The "Actual Cost Provided By Grantee" column must be completed based on a grantee review of the owner's certification of costs, as specified below:

- (1) Accuracy of Owner Reported Costs. In evaluating the owner's cost estimate, the grantee must first determine if the costs are accurately stated. For an audited project, substantial reliance must necessarily be placed on the ability and integrity of the CPA/IPA and the quality and scope of the accountant's examination. If the project has not been audited, the grantee must rely, at least in part, on its own records. These records include: evidence previously submitted by the owner to justify HDG drawdowns, information from monitoring visits, and information concerning contractor's liens or other cost/payment disputes known to the grantee. To the extent there are gaps in the grantee's records or reason to question evidence previously submitted, the grantee should request further documentation from the owner.
- (2) Eligibility of Owner Reported Costs. The grantee must determine that the costs presented are HDG program eligible in accordance with the Attachment to Appendix 8 of this Handbook. Actual costs that exceed the guidelines are only acceptable up to an amount in the approved HUD-90031.

If the cost certification has been audited under requirements of a lender or mortgage insurer, the

grantee must determine if the audited cost calculations have been adjusted for differences in cost eligibility criteria between the HDG program and the lender or underwriter. For example HDG and HUD mortgage insurance rules may differ in allowances for land value, legal and organizational costs, financing costs, builder sponsor non-cash equity, and funds expended for working capital or operating deficits. If the costs have not been appropriately adjusted, the grantee must do so.

(3) Reasonableness of Owner Reported Costs.

Section 2.01 of Article II of the HDG Grant Agreement requires that all eligible costs must conform with OMB Circular A-87, Cost Principles for State and Local Government. Circular A-87 states that allowable cost under a grant program must "be necessary and reasonable for proper administration of the Grant Program (necessary and reasonable for the purpose for which the funds are provided)."

The grantee, and later HUD, will determine if certified costs presented by the owner meet this standard. if any specific line item certified to by the owner varies by more than ten percent from the amount estimated in the approved HUD-90031, the grantee must evaluate whether the actual line item cost is reasonable. However, even if a line item is within the ten percent of the approved amount, information newly available subsequent to the date of the approved 90031 may indicate the costs to be unreasonable.

Example: If a builder's profit was approved and, in fact, paid to an identity-of-interest contractor who, it is discovered, subcontracted a vast majority of the work to one or two general subcontractors, such cost should be considered unreasonable.

Unreasonable amounts must not be included in the "Actual Costs by Grantee" information used by the grantee in completing form HUD-90025.

(4) Narrative. After completing form HUD-90025, the grantee must prepare an accompanying narrative to describe the following.

(i) Documentation obtained by the grantee and other grantee efforts to verify the accuracy, reasonableness, necessity and eligibility of project costs.

6-8

(ii) Justification of all "Actual Cost Provided by Grantee" line items which vary by more than

ten percent from or were not included in "Approved" costs.

- (iii) Explanation of all "Actual Cost Provided by Grantee" line items which vary from the amount reported by the owner.
- (d) Grantee Determination of Final Grant Amount. The grantee, or its designee, must complete Section A of form HUD-90026, Determination of Grant Amount and Equity Investment (Appendix 9 of this Handbook), to determine whether the grant amount warranted by project costs was greater than, equal to or less than the HDG funds disbursed under the U.S. Treasury Letter of Credit.

The final grant amount determined using form HUD-90026 will be the lesser of: (a) The maximum amount listed in the Grant Agreement, (b) fifty percent of actual development costs (or of replacement cost, if approved by HUD), or (c) the amount determined by subtracting all non-HDG financing commitments specified in Exhibits B, C, and D of the Grant Agreement from the "Actual" total project costs in form HUD-90025 provided by the grantee.

- (1) If HDG funds disbursed were greater than warranted, the grantee shall repay the difference to HUD and HUD will reduce any remaining balance in the U.S. Treasury Letter of Credit for the project to zero. HUD will work with the grantee to devise a schedule for repayment should the need arise.

In the event of a required repayment of excess HDG drawdown, the grantee should determine, through the analysis specified in paragraphs (e) and (f) below, which project financing source(s) failed to meet commitment(s) in the Grant Agreement. The grantee should require the owner to obtain from such source(s), and transfer to the grantee, funds necessary to offset the repayment to HUD for excess HDG drawdown. For example, if the owner substituted HDG funds for a portion of his equity commitment, the grantee would offset its refund to HUD by recovering from the owner the outstanding equity requirement. (See paragraph (e) below.) As a second example, if excess HDG draws substituted for other committed debt financing, the grantee would enforce the owner's commitment to borrow the additional funds, and so recover the outstanding excess HDG drawdown.

Excessive HDG drawdowns may result from the grantee's failure to enforce the requirement that HDG funds be

financing sources in accordance with the leveraging ratio and as prescribed in the December 15, 1985, memorandum HDG Program Policies: Construction/Drawdown Period, to all grantees. In any event, the grantee must assume ultimate responsibility for repaying HUD for any excess HDG draws.

- (2) If HDG funds disbursed were dual to those warranted and HDG funds remain available in the grantee's letter of credit with the U.S. Department of Treasury, HUD will reduce the project account under the grantee's letter of credit to zero.
  - (3) If HDG funds disbursed were less than those warranted and additional HDG funds are available in the project's U.S. Treasury Line of Credit account, the sum to which the project is entitled may be drawn down, and any remaining balance shall be reduced to zero.
- (e) Grantee Review of Owner's Certification of Sources of Financing.

After determining the final grant amount, the grantee shall evaluate the owner's certification of financing sources by identifying all resources committed in Exhibits B, C and D of the Grant Agreement as may be amended and determining if all non-HDG commitments, other than the equity, were met.

Owner's funds reimbursed prior to settlement or provided from project debt will not constitute equity. If there is reason to question the accuracy or completeness of the owner's certification, HUD encourages the grantee to require a current title report or check county land records to identify all project lienholders and the amount of secured debt. The evidentiary materials submitted by the grantee to HUD prior to commencing HDG drawdowns may also assist in substantiating the owner's certification of financing sources.

If an operating subsidy required by the Grant Agreement from a non-HDG source is proposed for reduction or elimination, the grantee must review the owner's justification and state whether the change will endanger project feasibility or compliance with rent affordability requirements in the Grant Agreement.

If a grantee determines that the owner's certification does not accurately represent sources or amounts of financing, the grantee must prepare a corrected list of sources and amounts. The grantee's final conclusions will be used in determining the owner's equity contribution (see paragraph f below).

Grantee comments, documentation, and if applicable, a corrected list of sources and amounts must be attached to form HUD-90026.

- (f) Grantee Determination of Owner Equity Investment. Using Section C of form HUD-90026, the grantee shall determine if actual equity invested in project development cost matches the equity requirement in Exhibits C and D of the Grant Agreement. Actual equity investment is determined by subtracting the amounts of HDG drawdowns, grants and non-HDG project debt used to pay eligible project costs from actual total costs in form HUD-90025. The grantee should not consider, in this calculation, financing for costs not considered in the form HUD-90025 determination, e.g., funding for rent subsidies and long term operating deficits by owner, grantee, HDG, or state government.

If the owner has not met the equity requirement, such contribution must be made as an immediate cash payment to the grantee, except as specified below:

- (1) To the extent that the owner has drawn down excess project loan proceeds (other than HDG) in lieu of a required equity contribution, the owner may substitute immediate repayment of the excess project debt for payment to the grantee.
- (2) To the extent that an owner's outstanding equity requirement would be met by owner payments to cover an initial operating deficit in accordance with the Grant Agreement, the owner may execute an agreement with the grantee to pay the grantee any equity balance due on the earlier of the project breakeven point (when net income covers debt service) or the end of a predetermined and reasonable rent-up period.

Funds which are remunerated to the grantee as a cash payment of an owner's equity requirement shall be considered program income, unless the grantee determines that these funds should be used to reimburse itself for grantee payments made to HUD for excessive HDG drawdowns as per Paragraph d (1) above.

- (g) Grantee Certification of Settlement Findings and Transmission to HUD. The grantee shall use its determinations of final costs, grant amount and equity investment from the completed form HUD-90025 and form HUD-90026 to complete the Certification of Settlement Findings, form HUD-90027 (Appendix 10 of this Handbook). The final certification must be signed by the grantee's CEO.

The completed Certification of Settlement Findings shall be the first page of the grantee's Project Settlement Submission package. To complete the package, the grantee

shall attach the following:

6-11

- (1) the grantee's Determination of Project Costs (form HUD-90025) accompanied by a narrative in accordance with Paragraph 6-4 above;
  - (2) the grantee's Determination of Grant Amount and Equity Investment (form HUD-90026) accompanied by comments/adjustments of the owner's financing information and any proposed operating subsidy commitment revision;
  - (3) the owner's Certification of Project Costs and Sources of Financing accompanied by any auditor's opinion, notes and schedules; and,
  - (4) other documentation.
- (h) HUD Review and Project Settlement Completion. HUD will review the grantee's Project Settlement Submission (see Paragraph 6-6 of this Handbook) and transmit written findings to the grantee within 45 days of receipt of the submission. The grantee must provide a written response within 30 days of receipt of HUD findings after which HUD has 10 days to follow-up or make a final determination. When all issues have been resolved, HUD shall prepare, execute and transmit to the grantee a Project Settlement Agreement (see Paragraph 6-7) for execution by the grantee's CEO.

#### 6-5. RECOMMENDED AUDIT GUIDELINES FOR OWNER'S COST CERTIFICATION

Audits of owner's cost certifications for HDG projects may be mandated by the grantee, performed at the owner's option or required by a lender or mortgage insurer. In the event of the latter, the audited cost certification should be adjusted to account for differences between cost eligibility standards of the lender or mortgage insurer on one hand, and the HDG Program on the other. If an audit is grantee mandated or performed at the owner's option, HUD strongly encourages conformance with Generally Accepted Government Accounting Standards (GAGAS). The remainder of this paragraph describes GAGAS guidelines as they apply to an HDG project audit:

- (a) Guidelines Governing Selection and Conduct of Auditor. If not certified, the Independent Public Accountant must have been licensed or registered by a regulatory authority of a state or other political subdivision of the United States. In states that do not regulate the use of the title "public accountant," only Certified Public Accountants may be used.

6-12

The auditor must be free from personal or external impairments to independence, as well as organizationally independent, and shall maintain an independent attitude

and appearance in conformance with GAGAS as established by the General Accounting Office.

(b) Accountant's Opinion. The accountant must verify the certification of actual costs and express an opinion as to whether the owner's certification of actual cost presents fairly the actual cost of the project. Allowable costs are those defined as eligible in the Attachment to form HUD-90025 or previously approved by HUD. The accountant's opinion must be supported by appropriate schedules of actual cost, as well as appropriate notes and opinions.

(c) Audit Scope and Coverage.

- (1) The audit work must be sufficiently comprehensive in scope to permit the expression of an opinion on the certification of actual cost and must be prepared in accordance with generally accepted auditing standards.
- (2) If an adverse opinion is expressed, the reasons must be fully explained in the audit report.
- (3) Sufficient audit work must be performed for the IPA to conclude whether, based on applicable HDG program criteria, the costs incurred were eligible under the terms of the contracts and in accordance with HUD's requirements. The accountant's opinion, certification, and comments are to be based on audit work performed. Audit work will usually be performed on a selective test basis, to the extent deemed appropriate by the IPA.

(d) Audit Standards.

- (1) The audit work must be performed in accordance with professional standards established by the American Institute of Certified Public Accountants (AICPA) and generally accepted government audit standards as set forth in the General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions (1981 revision).
- (2) All working papers are expected to conform to the guidelines prescribed in the AICPA Statements on Auditing Standards.
- (3) In determining cost, the auditor may uncover certain kickbacks and rebates which must be deducted from total costs incurred

6-13

for purposes of the certification of actual cost.

- (4) The IPA is also required to review, evaluate and

comment on the adequacy of the accounting records and procedures and the system of internal controls maintained, including the handling of funds. The auditors shall report on their study and evaluation of internal accounting controls made as part of the financial and compliance audit. They shall identify as a minimum:

- (i) The entity's significant internal accounting controls (the controls identified that were not included in the study and evaluation), and
- (ii) The material weaknesses identified as a result of the mortgagor's and/or contractor's failure to adhere to HDG requirements applicable to the project.

- (5) The certification of cost must be based on an examination made in accordance with generally accepted auditing standards and include tests of the accounting records and such other auditing procedures considered necessary. An examination which satisfies the professional standards established by the AICPA and General Accounting Office will satisfy the requirements of HUD.

(e) Deficient Audit Work.

Grantees and HUD state/area offices will perform careful reviews of cost certifications. Differences of opinion may arise from genuine misunderstandings of HUD instructions or honest differences of opinion clearly identifiable as such. If there is any reason for the HUD state/area office to suspect that the differences arise from causes other than those cited above, the HUD Office of Inspector General shall be called in to audit the owner's books and the audit working papers before cost settlement may be concluded. Depending on the nature of any deficiencies identified, administrative sanctions may be initiated against the IPA and could result in denial of participation in HUD programs. If circumstances warrant, deficient work will be referred to the State Board of Accountancy or the AICPA.

- (f) Exit Conference. At the conclusion of the audit, an exit conference should be held with the owner to discuss the cost certification and any audit findings. Appropriate comments should be obtained for inclusion in the auditor's report if: (1) audit officials do not agree with the accuracy and completeness of the facts

6-14

presented; (2) any corrective action is planned based on the auditor's observations; or (3) no actions are to be taken on deficiencies observed.

- (a) Overview. The Multifamily Division Production Branch is responsible for HDG project settlement responsibilities in the HUD state/area office. The HDG Program Coordinator assumes the lead role except that the Director, Office of Housing, or Director, Multifamily Division may assign a Mortgage Credit Analyst to perform the technical review of the grantee's Project Settlement Submission. The Cost Analyst may also be consulted in the Project Settlement Submission review.

It is recommended that the HDG Program Coordinator make the initial review. If there are problems, for example, if there has been no audit or if there are questionable items, technical assistance can be requested from the Mortgage Credit Analyst, Cost Analyst, or other technicians.

HUD's roles in the project settlement process are as follows:

- (1) approve initiation of project settlement;
  - (2) take appropriate action if the grantee does not initiate project settlement in a timely manner;
  - (3) within 45 days of receipt,
    - (i) review the grantee's Project Settlement Submission for compliance with these procedures;
    - (ii) revise the grantee determinations of project costs, final grant amount, and required equity investment; and,
    - (iii) send a letter of findings to the grantee;
  - (4) draft, execute, transmit and enforce a HUD-Grantee Settlement Agreement.
- (b) Initiating Project Settlement. After receiving the HUD-90024 Certification of Readiness to Initiate Project Settlement (Appendix 7 of this Handbook) from the grantee, the HUD state/area office reviews its monitoring records and determines whether to concur with the grantee's certification.

#### 6-15

HUD must notify the grantee in writing within 10 days after receiving the "Certification of Settlement" that either:

- (1) HUD records indicate that all preconditions (see Paragraph 6-2) to settlement have been satisfactorily completed to the extent verifiable

so that project settlement can proceed, or,

- (2) HUD does not agree that the preconditions have been or are likely to be completed. Such notification must identify the inadequacies.

Upon resolution of any inadequacies, HUD must provide final written notification that project settlement can begin. The date of this notification initiates the 9-day clock for the grantee's Project Settlement Submission.

- (c) HUD Response to Grantee's Failure to Initiate Settlement. In the event that HUD monitoring identifies inordinate delays in either achievement of the preconditions for settlement or grantee initiation of project settlement after the preconditions have been achieved, HUD will notify the grantee that unless project settlement begins and concludes within a reasonable interval, the grantee will be found in noncompliance with HDG program policies and that continued noncompliance by the grantee may jeopardize its ability to compete in future HUD program competitions. The HUD state/area office may also respond to continued noncompliance by assuming the grantee's responsibilities for project settlement and requiring an audited cost certification from the owner. For further information see Paragraph 6-7.
- (d) HUD Initial Processing of Grantee's Project Settlement Submission Within 90 days after HUD approves initiation of cost settlement, the grantee must submit a Project Settlement Submission. When this occurs, the HDG Program Coordinator and/or other Multifamily staff shall do the following:
  - (1) Receive and log in the grantee's Project Settlement Submission,
  - (2) Review the submission, for completeness. The submission shall include:
    - (i) The Certificate of Settlement Findings, form HUD-90027 (Appendix 10 of this Handbook) signed by the grantee's CEO or other official eligible to sign the original Grant Agreement.
    - (ii) The Determination of Project Costs, form HUD-90025 (Appendix 8 of this Handbook), and the narrative required by Paragraph 64 (c) (4).
    - (iii) A Determination of Grant Amount and Equity Investment, form HUD-90026 (Appendix 9 of this Handbook) accompanied by the grantee's comments or adjustments to the owner's financing source information.

- (iv) The owner's Certification of Costs and Sources of Financing, any accountant's opinion with notes or schedules, and any proposed changes to a long term operating subsidy; and,
  - (v) Other documentation used by the grantee in reviewing the owner's information, e.g., a title report.
- (3) Copy for the HUD technical reviewer (HDG Program Coordinator or Mortgage Credit Analyst) the latest approved HUD-90031, the Grant Agreement and any amendments thereto, for the project. If the file appears to be incomplete, e.g., an amendment is missing or a revised HUD-90031 is referred to in Exhibit A of the Grant Agreement but not included, contact the HUD Headquarters Development Grant Division for the missing document(s).
- (4) Forward to HUD technical reviewer: copies of the Grant Agreement and amendment; the Project Settlement Submission; and blank copies of form HUD-90025 and form HUD-90028;
- (e) Technical Reviews may be coordinated by the HDG Program Coordinator, Mortgage Credit Analyst, or other appropriate staff designated by the Housing Director or Multifamily Division Director.

It is recommended that the HDG Program Coordinator make the initial review. If there are problems, for example, if there has been no audit or if there are questionable items, technical assistance can be requested from the Mortgage Credit Analyst, Cost Analyst, or other technicians.

If the HDG project has a HUD insured or coinsured mortgage, the cost certification may be completed prior to or simultaneously with the review of HDG Project Settlement Submission. However, it would be beneficial to use the mortgage insurance cost certification particularly the HUD 2331(a) to complete the HDG settlement first since the final grant and equity determinations may affect the final mortgage amount.

Simultaneous Processing for HDG Settlement and Mortgage Insurance Final Closing. HDG Projects with HUD insured or coinsured mortgages should utilize and adjust the FHA cost certification for the HDG Settlement and HDG Settlement should occur before the first

6-17

mortgage loan closing. Notwithstanding the above, the HUD state/area office or coinsurer shall complete the HUD forms 2331 and 2331A after obtaining the owner's and contractor's certifications and provide these to the grantee for its settlement analysis. The HUD state/area

office should be aware that its form 2331A analysis of the maximum insurable mortgage may be affected by a decision at HDG settlement to reduce the HDG.

The grantee shall obtain forms 2331 and 2331A from HUD or the coinsurer prior to completing form HUD-90025 for HUD insured/coinsured projects. For projects with straight HUD mortgage insurance, the grantee should rely substantially on the accuracy and reasonableness of HUD's analysis, although the grantee needs to adjust costs for HDG Program eligibility and remains ultimately responsible for all cost determinations.

Obtaining contractor's cost breakdown/certification. These should be obtained by the grantee or HUD if there is a concern about the accuracy or reasonableness of hard costs, and must be provided by the owner upon request. For HUD insured and coinsured projects, the owner shall provide both forms 2330 and 2330A to the grantee as part of its cost certification.

Technical reviews shall be conducted as follows:

- (1) Review form HUD-90025, in consultation with Production Branch staff as appropriate, to determine:
  - (i) If the "Actual" costs are eligible in accordance with the Attachment to form HUD-90025. "Actual" costs that exceed the guidelines, if reasonable, are acceptable up to the amount approved in the HUD-90031.
  - (ii) In accordance with OMB Circular A-87, if the "Actual" costs are "necessary and reasonable for proper and efficient administration of the Grant Program, necessary for the purpose for which the funds are provided." For each line item "Actual" cost varying from the "Approved" amount by more than ten percent, has the grantee provided a satisfactory explanation? For any other line items, has information newly available subsequent to the date of the approved 90031, indicated the cost to be unreasonable?
  - (iii) The acceptability of the grantee explanation of differences between costs certified by the owner and the grantee's own determinations in form HUD-90025.
- (2) If the project was audited, review the accountant's opinion and any notes or schedules attached

thereto:

- (i) Since the construction contract, change orders, itemized cost breakdown, construction draws, disbursement control over mortgage (HDG or otherwise) proceeds and other pertinent documentation associated with the development of the project may not be available for analysis, substantial reliance must be placed upon the ability and integrity of the CPA/IPA and the quality and scope of the accountant's examination.
  - (ii) If the audited cost certification was provided in satisfaction of lender or FHA mortgage insurance/coinsurance requirements, examine whether the certification was adjusted to account for differences between the lender's or FHA cost eligibility standards and HDG eligibility standards. If not, consult with Headquarters in making such adjustments.
- (3) If the project was not audited and there are concerns about the eligibility or reasonableness of form HUD-90025 costs, request further documentation from the grantee, such as evidence from the owner used to justify HDG drawdowns or information about owner contracts.
- (4) If the result differs with any grantee conclusions, develop an alternative form HUD-90025.
- (5) Review the owner's certification of sources of financing, along with grantee comments and revisions, as follows:
- (i) Determine if the sources of financing and amounts from each source are consistent with documentation provided and other information available to the reviewer.
  - (ii) Determine if all commitments to finance construction period costs in Exhibits B, C, and D of the Grant Agreement have been met.
  - (iii) Determine if all project operating subsidy and deficit coverage mechanisms required by the Grant Agreement are in place. If the owner/grantee proposes to eliminate or reduce any non-HDG operating subsidy mechanism,

6-19

determine if sufficient justification is provided that project feasibility and Grant Agreement commitment(s) to provide lower income/very low income units are not

endangered.

- (6) Review the accuracy of the calculations in form HUD-90026 in view of conclusions on costs and sources of financing. Prepare a revised form HUD-90026 on the blank form provided, as appropriate. If the review of costs and financing sources revealed an unmet commitment in the Grant Agreement, form HUD-90026 will be affected as follows:
  - (i) If project debt or other non-equity source was substituted for equity funds, form HUD-90026 should indicate that the owner's equity requirement was not met.
  - (ii) If unwarranted HDG drawdowns were substituted for other committed funds, form HUD-90028 should indicate that a grant reduction is required.
  - (iii) If an alternate source of funds was substituted for a commitment from any non-equity, non-HDG funding source, form HUD-90026 will not indicate any further action required since the substitution would not affect the owner's equity requirement or grant amount.
- (7) Prepare a memorandum to the HDG Program Coordinator citing any concerns regarding project costs or sources of financing. Include any proposed revision to form HUD-90025 and/or form HUD-90026 based on the review.
- (8) Forward the review results and the grantee's submission to the HDG Program Coordinator.

(f) HDG Program Coordinator Final Review and Determination.

After receiving the completed review package from the technical reviewer, the HDG Program Coordinator shall do the following:

- (1) Review the technical reviewer's findings. If the technical reviewer differs with the grantee conclusions regarding costs or sources of financing, review the differences. Consult with the Housing Director or Multifamily Division Director or HUD Headquarters as appropriate.
- (2) Request further clarification or documentation, as necessary, from the grantee or owner and revise form HUD-90025 or form HUD-90028 accordingly.

- (3) Review the revised Part A of form HUD-90026 to

determine if the grant amount disbursed to the project was:

- (i) appropriate;
  - (ii) excessive, requiring a refund of HDG funds to HUD from the grantee; or
  - (iii) less than the full amount permitted by the terms of the Grant Agreement, justifying a final draw of the appropriate sum of funds under the line of credit.
- (4) Review the revised Part C of form HUD-90026 to verify that the owner's equity contribution has been made or will be made in accordance with the Grant Agreement. If any portion of the owner's equity contribution is outstanding (see form HUD-90026, Item C.5.), determine how the requirement shall be met in accordance with the following alternatives:
- (i) cash payment by the owner to the grantee. This alternative shall be used when eligible project costs were lower than estimated and Grant funds were used in lieu of equity.
  - (ii) cash payment by the owner to prepay a portion of a mortgage loan other than the HDG. This alternative may be utilized to the extent that the owner substituted excess secured debt for required equity in paying for project costs.
  - (iii) execution of an agreement between owner and grantee requiring the owner to pay cash to the grantee to the extent that actual project operating deficit costs during rent-up are lower than estimated. This alternative may be used if the Grant Agreement identifies initial operating deficit letters of credit or escrows as a portion of the owner's equity requirement.
  - (iv) a combination of items (i) through (iii) as determined appropriate based on a combination of circumstances.
- (5) Prepare and transmit a letter informing the grantee of the findings within 45 days of receiving the grantee's Project Settlement Submission.

6-21

- (6) Process the grantee's response (to be provided within 30 days) within 10 days of receipt so that resolved findings may be closed and remaining issues may be settled expeditiously. Negotiation of

outstanding issues may involve Headquarters Housing Development Grant Division staff.

- (7) Prepare, and coordinate execution of, the HUD-Grantee Settlement Agreement, in accordance with Paragraph 6-7 below.

#### 6-7. HUD-GRANTEE SETTLEMENT AGREEMENT

- (a) HUD Preparation. After all findings have been resolved, the HDG Program Coordinator shall prepare a HUD-Grantee Settlement Agreement in conjunction with Field Counsel.
- (b) Content. The Settlement Agreement is in the format of form HUD-90028 (Appendix 11 of this Handbook) and shall accomplish the following:
  - (1) Require the grantee's compliance with and enforcement of all governing HDG Program requirements for the remainder of the Project Term. The Grant Agreement defines the project term by indicating the date on which the project achieved 50% occupancy and the length of the project term.
  - (2) Permit HUD access to files as necessary to monitor the grantee's enforcement of all HDG requirements for the Project Term.
  - (3) Require the grantee to enforce specified owner payments to make up any equity shortfall, if appropriate, in accordance with Paragraph 6-6(f)(4) above.
  - (4) Require the grantee to refund to HUD any excess HDG drawdowns in accordance with Paragraph 6-6(f)(3) above, and prescribe a payment schedule.
  - (5) Permit the grantee, if the HDG drawdowns to date have been less than the full amount permitted by the Grant Agreement, to drawdown additional HDG funds up to the permitted maximum.
  - (6) Reduce HDG funds remaining in the grantee's U.S. Treasury Line of Credit account for the project to zero, after any draw permitted under item (5) above.
  - (7) If appropriate, incorporate new provisions regarding any operating subsidy mechanism.
- (c) HUD and Grantee Execution. The HDG Program Coordinator shall:
  - (8) Declare project development activities to be completed and financial settlement determinations for this period to be finalized.

- (1) Obtain Field Counsel concurrence and forward three copies of the HDG Settlement Agreement to the state/area office Housing Director or state/area office Multifamily Division Director for execution on behalf of HUD.
- (2) Forward all three originals of the HUD executed HDG Settlement Agreement to the grantee with instructions for execution by the grantee's CEO, transmission of two of the fully executed originals to the HUD field and Headquarters staff respectively, and maintenance of one fully executed document in the grantee's project file.

#### 6-8. SETTLEMENT REVIEW DELEGATED TO IPA/CPA

At HUD's and the Grantee's option, HUD's role in reviewing, revising and completing the HDG settlement package prior to execution may be delegated to an Independent Public Accountant (IPA) or Certified Public Accountant (CPA) meeting the standards of Paragraph 6-5(a) of this Notice Handbook. Selection, hiring and remuneration of the IPA/CPA will be the responsibility of the Grantee. This IPA/CPA must be independent of any auditor hired by the owner and must follow instructions provided in this Handbook.

The IPA/CPA will be responsible for determining accuracy and eligibility of all costs, the amount of grant earned and the amount of equity in the project. Based on these determinations the IPA/CPA shall determine if the project owner or any other party has failed to make all contributions required by the Grant Agreement and to what extent if any, excessive HDG funds have been drawn.

The IPA/CPA shall receive the Project Settlement submission completed by the Grantee. The IPA/CPA will review and revise as appropriate forms HUD-90024, 90025, 90026, and 90027. In determining whether costs were incurred, accurate, necessary, reasonable, and program eligible, special attention will be paid to the requirements of the HDG program which differ from other HUD programs.

Of special concern are projects involving an identity-of-interest contractor. Determine whether any entity claiming remuneration as a general contractor (i.e. builder's profit, overhead) has performed the requirements of that role. Fees may only be claimed once. When there

6-23

is no identity-of-interest contractor, the IPA/CPA will obtain a copy of the contractors certified costs, verify that the contractor is arms-length and compare the contract amount with the amount entered on line 8 of form HUD-90025.

After completing the review and revising the Settlement Packet as appropriate, the IPA/CPA will notify the Grantee if it is

determined that excessive funds were drawn down or insufficient equity was provided. The Grantee will be permitted a thirty day period to respond as indicated in Paragraph 6-4(h) of this Handbook. The IPA/CPA will review any Grantee response which will be incorporated in the findings as appropriate.

When any issues have been resolved, the IPA/CPA will prepare the form HUD 90028 and provide it to HUD for execution, supported by the corrected Grantee settlement submission and all backup documentation.

#### 6-9. QUALITY CONTROL - REVIEW OF SETTLEMENT PROCESSING

- (a) The state/area office Housing Director or Multifamily Division Director shall periodically review the quality of processing for all proposed Settlement Agreements.
- (b) Headquarters will monitor performance on a sample basis and hold the state/area office responsible for the quality of all settlement processing.
- (c) The main concerns regarding quality of processing are:
  - (1) Compliance of the final package with the requirements of this handbook relating to such matters as: obtaining an owner's certification of costs and sources of financing, securing appropriate cost documentation, math accuracy, confirmation of program eligibility of costs, adherence to line item cost ceilings, justification for costs which vary by more than 10 percent from estimates, accurate identification of Grant Agreement commitments by various parties, and appropriate use of audits.
  - (2) Good judgment and perceptiveness in identifying costs that may not violate any specific procedure or restriction of this handbook but which do not meet an overall standard of reasonableness as stated in the handbook and required by OMB Circular A-87.

#### 6-24

- (i) Example: The owner or an identity-of-interest "shell" contractor and a subcontractor, who in fact performs the customary functions of a general contractor, each receives a builder's fee and overhead costs. A copy of the contractor's certified costs should be provided as evidence that only one claim for profit and overhead is made.
- (ii) An owner claims "organization" cost paid to an identity-of-interest entity. Documentation of hours worked and reasonable rate of pay should be verified.

6-10. HUD'S AUTHORITY AND STRATEGY TO BRING GRANTEEES AND OWNERS TO SETTLEMENT

(a) Background

Grantees who, after HUD warnings, fail to follow through settlement or abide by HUD's findings, may be subject to a declaration of default, HDG repayment, and/or affirmative litigation. If a project owner's failure to cooperate is a cause for delay, the state/area office will require the grantee to act against the owner as HUD holds the grantee ultimately responsible.

Project owners who, after grantee or HUD warnings, fail to provide timely settlement information or abide by HUD's findings, shall be subject to HUD limited denial of participation (LDP). The state/area office should also contact other state/area offices where the owner does business to elicit similar action.

(b) Legal Authority to Hold the Grantee Responsible for Project Settlement

(1) General Grantee Accountability for Owner Performance

HUD generally holds the grantee ultimately responsible for grantee problems in meeting Grant Agreement requirements due to owners' failure to cooperate.

Article 12.01 of each Grant Agreement includes, in defining grantee default: Any breach of any covenant, agreement, provision or warranty of ...any Participating Party made in any agreement specified in Exhibits C and D of this Grant Agreement, which, in the opinion of HUD, adversely affects the performance obligations of the grantee or the Participating Parties as set forth in this Grant Agreement."

6-25

Because the Owner/Grantee Agreement is one such "agreement specified in Exhibits C and D of (each) Grant Agreement," any owner breach of the Owner-Grantee Agreement which adversely affects the obligations of the grantee under the Grant Agreement could trigger a grantee default under the Grant Agreement. Paragraph 13.01 a(v) of the Grant Agreement requires the grantee to "take appropriate legal action to enforce the owner's compliance with the Owner/Grantee Agreement."

Although from HUD's standpoint, repayment liability rests ultimately with the grantee, HUD will assist grantees to recover these funds from the third

party, especially owners, that benefitted from excess draws. HUD also recognizes that some grantees have made "best efforts" attempts to monitor drawdowns according to HUD requirements but inadvertently overdrew HDG funds. In these instances, if the grantee exhausts all remedies, including appropriate legal action, but fails to recover excess drawdowns from the appropriate third party, HUD may waive a portion of the grantee repayment liability.

(2) Responsibility to Submit Settlement Documents

Section 5.03(o) of the Grant Agreement requires all Owner/Grantee Agreements to include a provision requiring the owner to submit to the grantee a written certification upon project completion which must specify "the actual cost to the owner of labor, materials and necessary services for the construction of physical improvements for the Project in the format prescribed by HUD."

Section 6.04 of the Grant Agreement requires all Owner/Grantee Agreements to require the owner to "keep and maintain books, accounts, reports, files, records and other documents relating to the receipt and disbursement of funds from the grantee. Furthermore, any duly authorized representative of HUD shall ... have access to and the right to ... audit and examine all such ... documents until the completion of ... final settlement."

6-26

Failure of the owner to comply with the above cited requirements of Sections 5.03 and 6.04 of the Grant Agreement would adversely affect obligations of the grantee under the Grant Agreement to provide cost information required for project settlement.

Section 13.03 (a) of the Grant Agreement requires the grantee to "prepare a certificate of completion and final cost ... in the manner prescribed by HUD and submit it to the responsible HUD state/area office."

Sections 10.02 and 10.03 of the Grant Agreement also require grantee submission of a certification of completion specifying the cost of each activity and statements by participating parties, including the owner, verifying the information.

Because a violation of the owner's requirement to provide HUD or the grantee with project cost information would have an adverse effect on the grantee's obligations under the Grant Agreement, it could constitute a grantee default under Section 12.01 of the Grant Agreement.

(3) Responsibility to Abide by HUD Settlement Determination

Grantees' refusal at settlement to refund excess HDG payments required by HUD would also constitute a default of the Grant Agreement.

Section 13.03(b) of the Grant Agreement requires the grantee "to refund to HUD any Grant Funds advanced in excess of the final grant amount, as shown on the certificate of completion approved by HUD."

However, HUD has discretion to forgive a portion of the repayment requirement based on the following considerations: 1) a third party's (i.e. the owner's) primary responsibility for the excess drawdown; 2) the grantee's overall diligence in monitoring the grant, including compliance with HDG Program drawdown review procedures; 3) the likelihood based on the nature of the disallowance that a grantee who is diligently attempting to comply with the Grant Agreement and other outstanding program instructions might not have perceived that the disallowed cost or other basis for repayment requirement was ineligible and 4) that the grantee has taken every appropriate means to recover the funds from the owner or other third party.

Section 13.03(b) also states that "HUD will allow the grantee a reasonable period of time, as determined by HUD, to recover such excess funds as may have been advanced to a third

6-27

party." However, except at the Department's discretion based on the considerations described in the paragraph above, this does not relieve the grantee of its obligation to repay excess drawdowns if unable to recover the funds during the "reasonable period of time."

(4) HUD's Enforcement Authority when Grantee Defaults

In the event of grantee default, Section 12.02 (b) of the Grant Agreement provides that HUD may issue a warning letter "advising the grantee of the deficiency, establishing a date by which corrective actions must be completed, and putting the grantee on notice that more serious actions will be taken if the deficiency is not corrected." If the grantee fails to take corrective action in accordance with this warning letter, Section 14.02 of the Grant Agreement permits HUD, upon reasonable notice, to "reduce or recapture the HDG or take other appropriate action. Other appropriate action

Includes, but is not limited to, any remedial action legally available, such as affirmative litigation seeking declaratory judgment, specific performance, damages and any other available remedies."

(c) Strategy for Obtaining Overdue Grantee Settlement Documentation

- (1) If a project has completed construction, no HUD approvals of ownership changes, regulatory or handbook waivers, Grant Agreement amendments or amendments to any document reviewed by HUD as part of the evidentiary approval process (e.g., Owner/Grantee Agreements, covenants, regulatory agreements, loan notes, mortgages, or other encumbrances) shall be made, unless approval is determined by HUD Headquarters to be in HUD's interest, until the grantee has provided a Project Settlement submission and HUD has reasonable assurances that the grantee will abide by HUD's findings. Determination of HUD's interest must be made by Headquarters, in writing, prior to approval.
- (2) Transmit letters to grantees of all completed projects that have not yet initiated settlement. These letters shall warn grantees that failure to request HUD authorization to initiate settlement within 60 days after readiness to initiate settlement or failure to provide a settlement package within 60 days after HUD authorization will constitute a default under the Grant Agreement. The letter shall also reference HUD's available remedies.

A sample warning letter format is included in Appendix 12 of this Handbook. Follow up the letter with a telephone call or visit to the grantee to establish a schedule for initiating settlement and submitting a complete settlement package.

6-28

- (3) If the grantee fails to submit settlement documentation in a timely manner because the owner refuses to cooperate, the HUD state/area office shall provide direction and assistance to the grantee as follows:
  - (i) Technical assistance - The HUD state/area office may bring to the grantee's attention its rights and prerogatives under the Grant Agreement related to the owner's responsibility to provide cost certification. These include:
    - (A) A provision, usually numbered Section

5.03(o), in all Owner/Grantee Agreements requires the owner to submit to the grantee a written certification upon project completion which must specify "the actual cost to the owner of labor, materials and necessary services for the construction of physical improvements for the Project in the format prescribed by HUD."

(B) A provision required of Owner/Grantee Agreements by Section 6.04 of the Grant Agreement requires the owner to "keep and maintain books, accounts, reports, files, records and other documents relating to the receipt and disbursement of funds from the grantee."

(C) The Owner/Grantee Agreement provision cited in (B) above also requires that "any duly authorized representative of HUD shall have access to and the right to audit and examine all such documents until the completion of final settlement."

(ii) If the actions by the grantee to enforce the owner's obligations to provide a cost certification are unsuccessful, the state/area office shall inform the grantee that it is required by Paragraph 13.01 a (v) of the Grant Agreement to "take appropriate legal action to enforce the owner's compliance with the Owner/Grantee Agreement." Moreover, as required by Section 5.01(b) of the Grant Agreement, all Owner/Grantee Agreements have clauses recognizing the grantee's right and responsibility to initiate legal action against violating owners.

(iii) The state/area office should also assist the grantee in eliciting owner compliance by, when appropriate, issuing a Limited Denial of Participation against the owner or general partners within the state/area office jurisdiction and by referring extreme cases to Headquarters for suspension or debarment action.

6-29

The state/area office may elicit the support of the other HUD state/area offices within which the owner operates to initiate an LDP action when appropriate against the owner in other jurisdictions as well.

- (iv) If the grantee fails, despite HUD's assistance, to elicit a cost certification from the owner within a reasonable period of time, HUD shall instruct the grantee in writing that, while waiting for the sanctions to work, the grantee must complete its own cost certification based on available records.
  - (A) HUD should direct the grantee or an auditor hired by the grantee as its "authorized representative" under Section 6.04 of the Grant Agreement and pursuant to the Owner/Grantee Agreement to visit the owner and to demand access to and to audit and examine all documents relating to the receipt and disbursement of funds from the grantee. These documents include all the owner's records related to eligible project costs.
  - (B) If, in further violation of the Owner/Grantee Agreement, the owner refuses the grantee or grantee's auditor access to such records or indicates that the owner has not maintained such records, the grantee shall add consideration of the relevant violation to any legal action against the owner.
  - (C) When the grantee fails to obtain access to the owner's records, the grantee remains responsible for completing the cost certification. The grantee should already be in possession of documentation of all eligible incurred costs obtained from the owner or other third party required for HDG drawdown requests pursuant to the December 5, 1985 memorandum from Silvio de Bartolomeis to HUD grantees on HDG Program Policies: Construction/Drawdown Period. In addition, the grantee should contact the first mortgage lender to obtain its documentation of project costs, including draw records, owner cost certification, and any related audit.
  - (D) If the grantee, after unsuccessful and diligent efforts to obtain the owner's cost certification, substitutes cost information from its own analysis after examining the owner's and/or its own records, HUD will consider, pending results of any grantee legal action, temporary waiver of the Grant Agreement requirement that the grantee provide

the owner's cost certification.

- (E) At the time that the grantee believes that it has received the most complete cost information which it can obtain within a reasonable period of time, it should complete a settlement package based on this information and submit it to HUD.
- (4) Upon a determination by HUD, after providing reasonable opportunities to the grantee, that the grantee is not taking all necessary steps to expeditiously provide a Project Settlement Submission, the state/area office shall transmit a letter of default to the grantee. The letter shall be prepared in the following manner:
- (i) In accordance with Section 1 2.- (b) of the Grant Agreement, the default letter shall incorporate: "advising the grantee of the deficiency, establishing a date by which corrective actions must be completed, and putting the grantee on notice that more serious actions will be taken if the deficiency is not corrected."
  - (ii) The grace period for corrective action (i.e., transmitting the settlement package) shall be no more than three weeks.
  - (iii) The default letter shall describe the "more serious action" that HUD will take if corrective action is not taken by the grantee in accordance with the letter as described in paragraph 6-10(c)(5) below.
- (5) If the grantee does not respond to the default letter by three weeks after the end of the period for the corrective action stated in the default letter, the state/area office shall write a letter, as indicated in Section 14.02 of the Grant Agreement, "reducing or recapturing the HDG," demanding repayment of the HDG drawn down in accordance with the reduction or recapture. The letter should also indicate that the grantee's failure to comply within 30 days may result in litigation. The letter should be written pursuant to the following, as applicable:
- (i) if the grantee has not provided any cost information, recapture would be appropriate. If the grantee has provided incomplete information, reduce the HDG by the amount not justified by the information submitted.

- (ii) To facilitate claims collection action, the grant amount to be recaptured shall be declared a debt, with interest charged and accounts receivable established as specified in Section 2-5 of Handbook 1900.25.

6-31

- (iii) The recapture or reduction letter shall give the grantee a period of not more than 30 days to repay the grant or to provide both an initial installment and a plan acceptable to HUD for repayment of the balance.
- (iv) For additional guidance on the wording of this letter, refer to Section 2-6 and Appendix 5 of Handbook 1900.25. The Claims Collection Officer may be consulted in drafting this and any follow-up letter.
- (v) Because attempts to collect the debt follow other documented efforts by HUD to clear the underlying deficiency, the recapture letter should, in most cases, combine the language and purposes of the initial and two followup letters described in Handbook 1900.25. As an alternative, the state/area office Housing Director or Multifamily Division Directors may determine, at their discretion, that a single followup letter would be appropriate if the grantee fails to respond within 30 days.
- (6) If the grantee fails to satisfy the demands of the recapture or reduction letter, and the follow-up letter if applicable, within the 30 day period, the state/area office shall refer the matter to the following:
  - (i) to the Claims Collection Officer for claims collection action. This is very important because the Claims Collection Officer will initiate additional recovery actions under the Federal Claims Collection Act. The Development Grant Division shall also receive a copy of the transmittal referring the matter to the Field Claims Collection Officer.
  - (ii) To the Headquarters Development Grant Division for referral to OGC for civil recovery litigation. Notify the Development Grant Division by telephone or memorandum of the potential for legal action, and the Development Grant Division will raise the matter to OGC. When OGC accepts the case, referrals should include the entire project file including all correspondence and notations of telephone conversations not

previously forwarded to Headquarters.

- (7) It is very important that all oral communication with parties outside of HUD related to project settlement be documented with extensive written notes to the project file. These notes shall remain in the project file at least through grantee execution of the Settlement Agreement. Such notes are often critical to HUD's case in any legal actions required to achieve settlement.

6-32

- (8) Project documents shall be preserved as executed. Written notes or extraneous comments on these documents may be confusing.

#### 6-11. STRATEGY FOR INDUCING GRANTEE REPAYMENT OF EXCESS DRAWDOWNS

- (a) After HUD has received a Project Settlement Submission, no approvals of ownership changes, regulatory or handbook waivers, Grant Agreement amendments or amendments to any document reviewed by HUD as part of the evidentiary approval process (e.g., Owner/Grantee Agreements, covenants, regulatory agreements, loan notes, mortgages, or other encumbrances) shall be made by HUD until HUD has reasonable assurances that the grantee will abide by HUD's findings. Exceptions may be made in cases where HUD Headquarters determines approval to be in HUD's interest. Headquarters must determine HUD's' interest in writing, prior to approval.
- (b) After receiving the Project Settlement Submission, follow all processing requirements in Paragraph 6-6 of this Handbook. As indicated, all costs must be reviewed for accuracy, eligibility and reasonableness, and the grantee's indications of resource commitment levels from all parties must be cross checked with the relevant source documents.
- (c) If HUD's review of the documentation indicates that, based on the costs documented by the grantee and the resource commitment levels, there is a Grant repayment or additional owner equity infusion required in excess of that determined by the grantee, the state/area office shall so indicate by letter to the grantee.
  - (1) The letter shall clearly identify areas of differences with the grantee.
  - (2) The letter shall require the grantee to either submit additional documentation justifying other costs which may be eligible and reasonable based on the criteria of this handbook or submit a revised settlement submission based on HUD's findings.
  - (3) The letter shall indicate that if the grantee does not respond to HUD's request within 30 days, HUD

shall execute a Settlement Agreement reflecting HUD's conclusions based on the documentation provided to date.

- (d) If the grantee responds as requested, promptly analyze the new information or settlement submission provided. Based on such analysis, determine how much is owed by whom and execute a Settlement Agreement on this basis.

6-33

- (e) If the grantee does not respond within one month of its receipt of the HUD letter, staff shall prepare a settlement reflecting HUD's conclusions based on the HUD-approved documentation provided to date and have the state/area office Housing Director or state/area office Multifamily Division Director execute the settlement agreement as a unilateral HUD action. The Field shall transmit the executed document to the grantee requesting the grantee's execution and repayment of the amount owed to HUD.

- (f) Action to recover amounts owed to HUD by the grantee according to the HUD executed settlement shall be governed in the following manner:

- (1) The Settlement Agreement shall be transmitted to the grantee under cover of a letter from the state/area office Housing Director or state/area office Multifamily Division Director to the grantee's Chief Executive Officer in accordance with the following:

- (i) The letter shall indicate that the grantee, based on Articles XII and XIII of the Grant Agreement of the Grant Agreement, is liable for repayment of the amount of grant funds advanced in excess of the final grant amount in the HUD executed Settlement Agreement.
- (ii) Grantee shall be encouraged to recover excess grant funds from third party beneficiaries of excess drawdowns (e.g. owner who did not provide required equity or did not draw full amount of the first mortgage lender's loan commitment to the project.) The letter shall cite Grant Agreement provisions requiring the grantee to use all available means, including legal action, to recover funds owed from third parties.
- (iii) The letter shall direct the grantee, within 14 working days of receiving HUD's letter, to propose to HUD a plan of action to recover funds from third parties. The letter shall indicate that grantee failure to notify HUD of such plan of action within this time period, to make prompt changes in the action plan

required by HUD, or to pursue diligently the HUD approved plan would result in a HUD finding of Grant Agreement default, a demand for immediate Grant payment, and collection and/or legal action if the amount owed is not immediately repaid.

- (iv) If and only if HUD determines that the grantee has made a good faith effort from the outset to administer the

6-34

Grant according to outstanding procedures, including the Grant Agreement and the December 5, 1985 memorandum from Silvio de Bartolomeis to HUD grantees on HDG Program Policies: Construction/Drawdown Period and based generally on the other considerations described in Paragraph 6-4 of this handbook, the letter shall advise the grantee that its best efforts to pursue repayment of excess Grant funds from the appropriate third party could mitigate HUD's determination of grantee repayment liability if the efforts to pursue the third party ultimately fail.

- (2) Although the HDG Settlement process has no formal appeals process and the letter transmitting the Settlement Agreement need not indicate any right to appeal, the state/area office should review any appeal submitted in writing and respond in writing.
- (3) If the grantee fails: 1) to notify HUD of a plan of action within the 14-day time period, 2) to make prompt changes in an action plan required by HUD, pursue diligently the HUD approved plan, or, 3) except under conditions described in paragraph f below, to recover the excess funds from the third party in question within a reasonable period of time and promptly reimburse HUD, HUD shall send an additional letter to the grantee as follows:
  - (i) Requiring repayment from non-Federally derived sources of excess HDG drawdowns.
  - (ii) Specifying a period of not more than 30 days during which the Grantee must repay the amount owed or to provide an initial installment and a plan acceptable to HUD for repayment of the balance.
  - (iii) Indicating that if the grantee fails to comply within 30 days, interest will begin accruing on the amount owed, HUD will initiate collection action, and the matter will be subject to litigation.

- (iv) For additional guidance on the wording of this letter, refer to Section 2-6 and Appendix 5 of Handbook 1900.25. The state/area office Claims Collection Officer may be consulted in drafting this and any followup letter.
- (v) Because attempts to collect the debt follow other documented efforts by HUD to clear the underlying

6-35

deficiency, the recapture letter should, in most cases, combine the language and purposes of the initial and two followup letters described in Handbook 1900.25. As an alternative, the state/area office Housing Director or Multifamily Division Director may determine that a single follow-up letter would be appropriate if the grantee fails to respond within 30 days.

- (4) To facilitate claims collection action, the excess HDG drawdowns to be recovered shall be declared a debt, with interest charged and accounts receivable established through appropriate HUD Accounting staff in accordance with Section 2-5 of Handbook 1900.25.
- (5) If HUD determines that the grantee has made a good faith effort from the outset to administer the Grant according to outstanding procedures including the Grant Agreement and the December 5, 1985 memorandum from Silvio de Bartolomeis to HUD grantees on HDG Program Policies: Construction/Drawdown Period (taking into account the considerations described in Paragraph 6-9 of this Handbook) and the grantee fails to obtain third party repayment of excess Grant funds after diligently pursuing and completing a HUD approved plan of action, HUD, at the discretion of the official who executed the Settlement Agreement, may negotiate a reduced grantee repayment liability and/or favorable terms of repayment. A revised Settlement Agreement shall, in this case, be executed and transmitted to the grantee with a cover letter instructing the grantee to execute and comply with the revised Settlement Agreement.
- (g) If grantee fails to comply with HUD's repayment demand within the allotted period pursuant to the requirements of 6-10 (f)(3) above, the state/area office shall refer the matter, through the following:
  - (1) to the field Claims Collection Officer in the Office of Administration for claims collection action. This is very important because the Claims

Collection Officer will initiate further actions to recover the funds under the Federal Claims Collection Act. The Development Grant Division shall also receive a copy of the transmittal referring the matter to the Claims Collection Officer.

- (2) to the Headquarters Development Grant Division for referral to OGC for civil recovery litigation. Notify the Development Grant Division by telephone or memorandum of the potential for legal action. The Development Grant Division in turn, will

6-36

raise the matter to Headquarters OGC. When OGC accepts the case, referrals should include the entire project file including all correspondence and notations of telephone conversations not previously forwarded to Headquarters.

- (h) It is very important that all oral communication with parties outside of HUD related to project settlement be documented with extensive written notes to the project file. These notes shall remain in the project file at least through HUD and grantee execution of the Grant Agreement. Such notes are often critical to HUD's case in any legal actions required to achieve settlement.
- (i) Project documents shall be preserved as executed. Written notes or extraneous comments on these documents may be confusing.

6-37