

Chapter 13

Cost Certification

13.1 Projects that Must Certify

Cost certification is required for all insured multifamily projects, except when the mortgage is 80 percent or less of value and at least one of the following two criteria applies: the transaction involves tax credits, or the project is refinancing under Section 207/223(f).

13.2 Purpose of Certification

The purpose of certification is to establish the borrower's actual costs, including contractor's cost, and establish the "maximum insurable mortgage" for Final Endorsement of the insured mortgage.

13.3 Certifiable Costs

Certifiable costs are those costs that have been paid in cash or will be paid in cash within 45 days of final closing, except for:

- A. Land Value, which HUD will calculate,
- B. General Overhead, which is certifiable whether or not it is paid in cash,
- C. Builder's and Sponsor's Profit and Risk Allowance (BSPRA), which is cost certifiable whether or not it is paid in cash, where there is an identity of interest between the borrower and contractor, and
- D. Non-profit Developer's Fee, which is cost certifiable whether or not it is paid in cash, less amounts certified to and allowed on other line items.

13.4 Instructions for Projects Exempt from Cost Certification: Low Income Housing Tax Credits (LIHTC)s and non-Tax Credit

LIHTC

The Housing Economic Recovery Act (HERA) of 2008 affected the borrower's obligation to certify "actual cost" (as defined in the National Housing Act) under insured mortgage programs. If it is determined at the time of issuance of the Firm Commitment for insurance that the ratio of loan proceeds to the actual cost of the project is less than or equal to 80 percent, the borrower is not required to certify actual cost to HUD. This exemption affects construction, rehabilitation (including property acquisition), purchase or refinance of a multifamily housing project for which equity is provided through tax credits, e.g., LIHTC, Historic Tax Credits, or New Market Tax Credits. Since the actual cost is not known at the time of the issuance of the Firm Commitment, use in lieu of the actual cost, the *Total Estimated Replacement Cost* of the project (*see Section G, line 74 on the Form HUD-92264, Multifamily Summary Appraisal Report*). An example of this computation is below.

LIHTCs

- A. This example illustrates the applicability of the cost certification exemption for a new construction and substantial rehabilitation project using the lowest controlling mortgage criterion.

Total Estimated Replacement Cost of Project (Section G line 74 HUD-92264). \$
13,000,000

Tax Credit Equity for Mortgageable Items (Form HUD-92264-A), Supplemental To
Project Analysis, line I.11.b(2)\$ 5,000,000*

Maximum Insurable Mortgage Amount (Form HUD-92264-A)\$ 8,000,000

$$\text{\$ } 8,000,000 / \text{\$ } 13,000,000 = 62\%$$

B. Audit Fee

In cases that are exempt from cost certification, a Cost Certification Audit Fee, Section G line 66, on Form HUD-92264 is not applicable. The borrower and the general contractor may certify to their actual costs. Should they decide to cost certify per HUD's methodology, the audit cost is mortgageable.

Note that the borrower and the general contractor have the option to cost certify according to the guidance in Sections 13.6 through 13.19.

C. Substantial Completion Date

1. The substantial completion date is the date the Architect dates and signs the certification on Form HUD-92485, Permission to Occupy Project Mortgages (PTO). Upon execution, the

Architect certifies that the construction work is sufficiently complete in accordance with the construction contract documents such that the project may be occupied for the intended use except for acceptable items of delayed construction completion. The HUD Inspector examines the rental units for being occupiable, and, if so, with any exceptions noted, will complete the portion, "FHA Inspection Report" on the Form to verify whether construction is substantially complete, and the project is suitable for occupancy. The Form is subsequently signed by HUD's Authorized Agent granting approval of the PTO. Refer to Section 12.6.A for the full guidance on the issuance of a certificate of substantial completion. The Regional Center or Satellite Office will notify the borrower, general contractor, and lender, in writing of the substantial completion date so that preparation for final closing can begin.

To account for multiple buildings constructed under one insured mortgage, the Architect will approve a series of Permissions to Occupy as buildings are complete and units become available. When all buildings are complete the Architect will write on the front of the HUD-92485 indicating it is the final PTO.

2. The final trip report Form HUD-95379, HUD Representative's Trip Report will mark when project operations begin. In the absence of a cost certification cut-off date, the Production staff will enter "The Date of Visit" from the final HUD-95379 as the cost cut-off date in the HUD data system (e.g. DAP (Development Application Process) and advise the borrower of the date. The day after becomes the "Financial Assessment Subsystem (FASS) date" to mark the beginning of project operations and annual financial statement (AFS) reporting.

D. Treatment of Operating Income Generated During Construction

1. The borrower must account for all operating income generated during construction and ending three months before the originally scheduled date of the first principal payment under the mortgage. In cases such as new construction with partial occupancy approval as described in Section 12.14.D or a substantial rehabilitation tax credit project, without significant resident displacement, there may be considerable net operating income (NOI) (or interim income) generated during the construction period. This interim income may be used to pay for mortgageable and non-mortgageable items.

Therefore, the borrower must prepare an Operating (Income and Expense Statement) Statement covering the period from first occupancy (if occupancy occurred during construction, see Section 12.14.D) or from the date of substantial completion through the period ending three months before the date of the first principal payment of the originally scheduled mortgage. The borrower may include in the operating statement all soft costs incurred up to 60 days beyond this date, which will establish the cut-off date and the date for the operating statement. See Sections 13.8 and 13.12.B.5.j as a cross reference. The

day after the cut-off date begins, the FASS annual financial statement reporting and project operations reporting period.

Borrowers with project based rental assistance must submit a CPA prepared audited operating statement to meet FASS auditing requirements.

The Lender must submit the borrower's operating statement to HUD at least 30 days before the final endorsement scheduled date. If the operating statement evidences receipt of NOI during this period, the borrower can apply the interim income according to the following:

- a. If the replacement cost mortgage (Criterion 3) is not the controlling mortgage, any NOI generated during construction may be applied to cover shortfalls in mortgageable soft costs, change orders, initial operating deficit and escrows. At final endorsement the balance of funds may be distributed to the borrower or deposited to the project's Reserve for Replacement account or applied toward the amortization of the mortgage principal subject to HUD approval.
 - b. If the replacement cost mortgage (Criterion 3) is controlling the Mortgage Credit staff will do a calculation and determine if the interim NOI is equal to or greater than 1% of the original mortgage. If the interim NOI is greater than 1% of the original mortgage amount, the total amount of interim NOI is deducted from the certified replacement cost amount. When the NOI does not meet this 1% threshold, the borrower will apply the amount toward shortfalls, etc. as instructed in number 1a. above. The Lender must deposit any remaining balance into the project's Reserve for Replacement account or apply toward the amortization of the mortgage principal at final endorsement. There is no distribution to the borrower.
 - c. See Section 13.19.C below on the distribution prohibition for a borrower's affiliate or principal.
2. In those cases whereby interim income is not generated, or the borrower opts not to set a cost cut-off date, it is not necessary for a borrower to submit an operating statement. The Regional Center or Satellite Office will notify the lender, borrower, and general contractor, in writing, of the 100% final completion date from the final Form HUD-95379, HUD Representative's Trip Report. The Production staff will enter "The Date of Visit" date from the final HUD-95379 as the cost cut-off date, into the HUD data system. The day after this date will begin project operations and FASS reporting.
- E. Copy of Final Sources and Uses Statement. The lender may submit a copy of the final Sources and Uses Statement prepared by the state tax credit allocating agency to assist in the lender and HUD review of the final amounts of sources, income and uses.
- F. Modification to Form HUD-92580 – Determination of Maximum Insurable Mortgage

For those projects that are exempt from providing a cost certification, after substantial completion, the Regional Center or Satellite Office will issue a modified Form HUD-92580, as illustrated below. Strikeouts are illustrated on lines 2 and 10, in the example below:

1. (a) Original Mortgage Amount \$10,000,000.00
 (b thru e) are not applicable - *Insert N/A or cross through.*
2. ~~Certified Actual Cost~~ – *Strike certified actual cost and Insert*
Replacement Cost from Section G Line 74 \$13,000,000
3. Disallowed Cost (*Insert N/A*) \$ N/A
4. Recognized Actual Cost of Improvements ... (Sec. G Line 74) ... \$13,000,000
5. Land \$ _____
6. TOTAL LAND AND IMPROVEMENTS \$13,000,000
7. Statutory Percentage of Total Cost (____ % of item 6) \$ N/A
8. For Substantial Rehabilitation-Property Owned, enter the Lesser of:
 - (i) \$____ existing Mortgage Indebtedness on (Land and Improvements to be Rehabilitated) or
 - (ii) An Amount Equal To ____ % of the Fair Market Value \$____ of Land and Improvements
 Before (Repair or Rehabilitation) \$ N/A
9. TOTAL Line 7 plus line 8, (if any) \$ N/A
10. Maximum Insurable Mortgage in Multiples of \$100, (Item 1(a) or Item 6 whichever is the Lesser) \$10,000,000

NOTE: The Mortgage Credit staff should note on this Form that the project is exempt from cost certification due to the *loan proceeds* to actual cost being equal to or less than 80%. For this example, the actual percentage of the loan to cost is 77% (\$10M/\$13M).

Completion of the reverse side of the Form as follows:

Schedule 1 N/A

Schedule 2 Disallowed Costs: N/A

Schedule 3 Computation of Borrower's Initial Equity Investment

1. Total Land and Improvements (line 6 above)	<u>\$13,000,000</u>
2. Less: Maximum Insurable Mortgage (line 10 above)	<u>\$10,000,000</u>
3. Borrower's Initial Equity Investment	<u>\$ 3,000,000</u>

13.5 Types of Cost Certification

- A. Standard or "Long Form" Certification is required, except for projects permitted to use the "simplified" cost certification and for certification of projects insured under Section 207.
- B. Simplified Certification is restricted to projects involving 40 units or less of proposed construction or substantial rehabilitation and is used for projects under Section 207/223(f).
- C. Section 223(f) Certification is required for all projects insured under Section 207 except in cases for Section 207/223(f) transactions where the insured mortgage is 80% or less of the value.
- D. Section 223(f) Supplemental Certification is required for projects identified in paragraph C above, when completion of repairs is permitted after closing. The Certification is submitted 15 business days after repairs are confirmed complete.

13.6 Entities That Must Cost Certify

- A. The borrower must certify under all programs, **except** where HUD has determined at the time of issuance of the Firm Commitment that the insured mortgage under: a) Section 221(d)/220/231 new construction/substantial rehabilitation is 80% or less of replacement cost **and** the project is will benefit from LIHTC, Historic Tax Credits or New Market Tax Credits, or b) Section 207/223(f) refinance is 80% or less of value.
- B. When the borrower is required to cost certify, the Contractor must also cost certify when:
 - 1. The Contractor has an identity of interest with the mortgagor, whether such identity of interest existed or developed before or after the initial closing (for insured advances projects) or issuance of the Firm Commitment (for insurance upon completion projects); and/or
 - 2. The Contractor used the Construction Contract-Cost Plus, Form HUD-92442M, whether or not any identity of interest with the borrower existed or developed.
- C. When the Borrower is required to cost certify the subcontractors at any tier, equipment lessors, material suppliers and manufacturers of industrialized housing must cost certify where:
 - 1. The total of all subcontracts, purchases, and leases are more than 0.5% of the mortgage, and
 - 2. An identity of interest exists or comes into being between such subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing and either:

- a. The borrower; or
- b. The contractor, where the contractor must cost certify.

13.7 Cost Certification Sequence of Events

- A. Notification of Pre-Cost Certification Conference. HUD must notify the lender, borrower, and contractor when the project is 80% complete. HUD should notify new sponsors and general contractors as early as 70% completion. The letter should state that:
 1. The borrower, general contractor, their accountants, and the lender should attend the conference.
 2. Enclose with the letter is the contact information for the Fair Housing Information Clearinghouse , 1- (800) 767-7468 and the internet address for:
 - a. Handbook IG 2000.4 Consolidated Audit Guide for HUD Programs: http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/handbooks/oigh/2000.4
 - b. Four copies of each of the applicable forms: (http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/forms/hud9#group2):
 - (1) Form HUD-92330, Borrower's Certificate of Actual Cost.
 - (2) Form HUD-92330A, Contractor's Certificate of Actual Cost, if applicable.
- B. Conduct of the Pre-Cost Certification conference is the responsibility of the assigned HUD staff and should be held before the project is 90% complete. At the conference, HUD staff will explain:
 1. Substantial completion, administrative completion, and cut off dates.
 2. Documentation required for cost certification including the income statement and balance sheet.
 3. Remind the borrower and accountant that they are responsible for computing the liquidated damages/actual damages and incentive portions, if applicable, of the construction contract using the certified amounts on Form HUD-92330.
 4. Necessity for a careful review and completeness of the documentation including dates and signatures, and timeliness of the submission, HUD review, and final endorsement.
 5. Any problems with prevailing wage certifications or other labor issues.

- C. Cut-off date is established for computation of the cost certification. Submission and HUD approval of the cost certification must occur before final closing, except that the Section 223(f) supplemental cost certification is not required until completion of non-critical repairs deferred until after closing.
- D. The Borrower and General Contractor, if applicable, must submit the Certificate of Actual Cost to the lender to review prior to the lender's submission to the HUD assigned underwriter. The HUD underwriter will review the cost certification and determine the Maximum Insurable Mortgage using form HUD-92580
- E. E. The HUD issued Form HUD-92580, Maximum Insurable Mortgage, is a required final endorsement exhibit. Record in Schedule 1 of the Form any additional conditions that must be met as part of final endorsement.

13.8 Substantial Completion Date, Cut-Off Date, and Final Completion Date

- A. Completion dates.
 1. The substantial completion date for is the date the Architect dates and signs the certification on Form HUD-92485, Permission to Occupy Project Mortgages. The Architect is certifying that part of or all the construction work is substantially complete in accordance with the construction contract documents and that the project may be occupied for the intended use. The form is subsequently signed by HUD's Authorized Agent. Construction must be complete except for acceptable items of delayed completion and the Regional Center or Satellite Office will notify the borrower, general contractor, and lender, in writing, of the substantial completion date.
 2. The date the final HUD Representative's Trip Report (HUD-95379) is signed, begins the effective date for cost certification. The borrower has the option to include in the cost certification all soft costs incurred up to 60 days beyond this date. The date selected by the borrower is the "cut-off date" for the soft costs.
 3. The borrower's balance sheet and operating statement date must agree with the selected cut-off date.
 4. Final completion is the date the HUD Inspector signs the final HUD Representative's Trip Report, Form HUD-95379, provided that the Construction Manager subsequently endorses the trip report. Construction must be 100% complete.
 5. For financial reporting purposes, the day after the cut-off date is the commencement of operations and the projects' first year of reporting annual audited financial statements. This first year will cover the period from the day after the cut-off date to the project's fiscal year end. Once the certificate(s) of occupancy (Form HUD-92485) is issued, this

becomes the date Asset Management will begin monitoring the project's financial condition (e.g. monthly financial accounting reports).

13.9 Administrative Completion Date

The Regional Center Director may advance the completion date to prevent unnecessary accumulation of soft costs when projects which are nearly complete face unnecessary delay.

- A. The Regional Center Director may set an administrative completion date for any project when the monthly inspection reports show 95% completion of work and thereafter less than 2% increase in percentage of completion in any month.
- B. The Regional Center Director will notify the borrower, general contractor, and lender in writing of the administrative completion date and the following:
 - 1. The administrative completion date is the effective date for cost certification except that all soft costs up to 60 days beyond this date may be included at the option of the borrower.
 - 2. The date of the balance sheet and operating statement must be the same as the cut-off date selected by the borrower.
 - 3. Liquidated/actual damages for cost certification purposes will be computed using the administrative completion date. However, the general contractor is responsible for liquidated/actual damages through the date of substantial completion.
- C. Copies of the notification go to the HQ Docket, Office Docket and Closing Attorney's file.

13.10 Submission Date

The submission date for cost certification should be within 30 to 45 days after the cut-off date, and not less than 30 days before the desired final closing date.

13.11 Required Forms

- A. Form HUD-92330, Mortgagor's Certificate of Actual Cost [line-by-line instructions are contained in the MAP Forms Book or Handbook 4470.2 Chapter 4:
<https://www.hud.gov/sites/dfiles/OCHCO/documents/92330.pdf> and
https://www.hud.gov/program_offices/administration/hudclips/handbooks/hsgh/44702 .

- B. Form HUD-92330A, Contractor's Certificate of Actual Cost; see instructions contained herein at Sections 13.12, 13.16, and 13.17. The subcontractor, material supplier, industrialized housing manufacturer, and the equipment lessor are required to use this form to certify cost.
- NOTE:** When a project includes rehabilitation and new construction, a separate form is required for each, with a master form summarizing total project costs, including fees.
- C. Form HUD-2205-A, Borrower's Certificate of Actual Cost (Section 207 Pursuant to Section 223(f)), (line by line instructions are contained in the MAP Forms Book) the Form is located on HUDclips.org at the following link:
<https://www.hud.gov/sites/dfiles/OCHCO/documents/2205-a.pdf> .
- D. Statements of Sources and Uses and Settlement Statements may be used to meet cost certification requirements under the HERA exemption.

13.12 Required Statements and Certifications

For all projects, regardless of whether the project has a cost certification exemption, the following are required statements and certifications:

New construction and substantial rehabilitation - an unaudited balance sheet that covers the period from the date of initial endorsement through cut-off and an unaudited income statement covering the period from first occupancy (if occupancy occurred during construction, see Section 12.14.D) or from the date of substantial completion through the period ending three months before the date of the first principal payment of the originally scheduled mortgage.

Follow either A or B, below, depending on qualifications in A.1.

- A. Simplified Form of Cost Certification. Use Forms HUD-92330, HUD-92330A (if a cost-plus construction contract was used or an identity of interest exists between the borrower and the general contractor). An accountant's opinion is not needed.
1. Simplified cost certification is permitted for new construction or substantial rehabilitation project's involving 40 units or less and for refinancing or purchase of existing properties under 207/223(f).
 2. If there is an identity of interest between a subcontractor, material supplier, equipment lessor, or manufacturer of industrialized housing and the borrower and/or general contractor must cost certify, and the total of all identity of interest subcontracts, purchases and leases is more than 0.5% of the mortgage, the identified party uses Form HUD-92330A. This requirement established by the Agreement and Certification, Form HUD-93305M, applies in all cases.
 3. An un-audited balance sheet of the borrower entity, as of the cut-off date is required in all cases. Format and content of the balance sheet must follow Section 13.12.B.4, below.

4. An un-audited operating statement is required if occupancy occurred during construction. Format and content of the operating statement must follow Section 13.12.B.5, below.

B. Long Form Cost Certification. For cases that do not qualify for simplified cost certification based upon paragraph A.1, above, please submit the following:

1. Borrower's Certificate of Actual Cost, Form HUD-92330, supported by an accountant's opinion (refer to Section 13.12.B.6).
2. Contractor's Certificate of Actual Cost, Form HUD-92330A, supported by an accountant's opinion (refer to Section 13.12.B.6), is required if there is an identity of interest with the borrower or if a cost-plus construction contract was used.
3. Subcontractors, suppliers, and equipment lessor with an identity of interest with either the borrower or general contractor must submit Form HUD-92330A supported by an accountant's opinion.
 - a. Material suppliers. Attach to Form HUD-92330A a sheet showing:
 - (1) Quantities furnished.
 - (2) Sources from which the materials were obtained.
 - (3) Unit prices paid to the sources, brand names, model numbers, sizes, lumber grades, etc., as applicable.

NOTE: No amount will be included for general requirements (e.g.: job overhead).

b. Equipment Lessor. Attach to Form HUD-92330A a sheet showing:

- (1) Dates the equipment was acquired,
- (2) Age of equipment at acquisition date,
- (3) Brand names and model numbers,
- (4) Sizes,
- (5) Dates and length of time used, and
- (6) Rates charged.

(a) The Lessor(s) must certify that:

- (i) The rates charged were not more than the local going rate obtainable in the area, including any maintenance and repair.
- (ii) The time charged was not more than essential for the project.
- (iii) The charges did not exceed the purchase price of the equipment.

(b) Lump Sum Basis. Instead of providing an attachment containing the above information, the lessor(s) may elect to certify to charges at 85% of the local

going rates for identical equipment under arms' length (lump sum) leases. When using this alternative, the lessor agrees:

- (i) The Regional Center is the sole judge of the reasonableness of the time and rates charged, and
 - (ii) Equipment maintenance and repair expense is the responsibility of the lessor(s) and is not included as an additional cost.
- (c) Subcontractor's equipment. Costs for subcontractor(s) equipment, whether owned or rented, are considered in the markup for overhead and profit. These costs shall be reflected in the total subcontract and in the prior approval of identity of interest entities. A separate certification of the equipment is not required.
- (d) Manufacturer of Industrialized Housing. Attach to Form HUD-92330A, a breakdown of Division 13, Special Construction showing:
- (i) Manufacturing costs.
 - (a) Labor
 - (b) Materials
 - (c) Sales and any other taxes
 - (d) Factory overhead
 - (e) General overhead and profit

NOTE: The manufacturer's accounting system must follow generally accepted accounting procedures, which will allow certification of the actual cost of manufacturing by a Certified Public Accountant or Independent Public Accountant. No amount will be included for transportation or work at the project site.

- (ii) Transportation costs, factory to project site (if provided by manufacturer).
 - (a) Labor
 - (b) Equipment
- (iii) On-site erection costs (if provided by manufacturer).
 - (a) Labor
 - (b) Equipment
 - (c) Materials
 - (d) General requirements (job overhead)
- (iv) The remainder of the manufacturer's Form HUD-92330A is completed per outstanding instructions.

NOTE: There can be no duplication of manufacturing costs, e.g., repair of components damaged in shipment.

4. An audited balance sheet of the borrower entity, as of the cut-off date is required.

a. The balance sheet must contain the following certification:

I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the borrower [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of (Name of borrower or owner) financial position as of (date of financial statement).

Signed this ____ day of _____, 20_____ (Signature of authorized agent with name printed or typed under signature)

WARNING: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)

- b. Furnish reconciling information if short-term liabilities on the balance sheet do not agree with Column B of Form HUD-92330.
- c. Explain the purpose of all liabilities in the notes to the financial statement and include repayment requirements of the liabilities. Take special care to note any liabilities included for repayment on the balance sheet that were not disclosed during the firm processing stage or before initial endorsement. If such liabilities are found, inform the borrower that the liabilities cannot be an obligation of the project; repayment is the responsibility of the borrower. These liabilities will not be considered (allowed nor disallowed) in the review of the cost certification. When non-disclosures are found, it requires a detailed review of cost certification Forms HUD-92330 and HUD-92330A.

- d. If proceeds and obligations from project syndication are passed through the books and records of the borrower entity, reflect receivables as an asset of the borrower entity.
 - e. The notes to the balance sheet must identify the original amount of and summarize the expenditures from the working capital deposit.
5. An audited operating statement is required if occupancy occurs before the cost certification cut-off date.
- a. The statement must contain the certification contained in Section 13.12.B.4.
 - b. Prepare the operating statement on an accrual basis.
 - c. The statement covers the beginning of marketing and rent-up activities (or date of initial endorsement in rehabilitation projects where occupancy is continuous) to the cut-off date.
 - d. Marketing and rent-up activities will start no later than 6 months before the issuance of the first Permission to Occupy-Project Mortgages, Form HUD-92485.
 - e. The statement must show the actual dates covered rather than language such as "From the Date of Commencement of Marketing and Rent-up Activities, etc."
 - f. The statement must show income from all sources. Do not consider security deposits as income.
 - g. The operating statement should not contain any expense items that were paid or should have been paid from the working capital deposit or otherwise included in cost certification.
 - h. Operating expenses may include:
 - (1) Expenses directly relating to renting the project, such as:
 - (a) Rental commissions customary for the type of project, if any, and
 - (b) Marketing and advertising expenses.
 - (2) Purchase of furnishings, fixtures, equipment and supplies not paid from the working capital deposit and in the eligible replacement costs.
 - (3) Reasonable fees for preparing any Federal, State, or local tax return information required of the project.

For example: If the borrower entity is a partnership, the cost of preparing both Form 1065, U.S. Partnership Return of Income, and related K Schedules may be considered. Do not recognize the cost of preparing a partner's personal Form 1040 return.
 - (4) Electricity, gas, water, and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.) to the extent they are not included in construction cost of Form HUD-92330, Borrower's Certificate of Actual Cost, or HUD-92330A, Contractor's Certificate of Actual Cost.
 - (5) Management fee stated in the contract.

- (6) Services not covered by the management fee under Chapter 3 of Handbook 4381.5, Compensations for Management Services in Multifamily Housing Projects with Insured or HUD-Held Mortgages.
- i. Operating expenses may not include:
 - (1) Depreciation
 - (2) Interest, taxes, property insurance premiums, and mortgage insurance premiums that are reflected in Form HUD-92330, Borrower's Certificate of Actual Cost.
 - (3) Salaries paid to principals of the sponsor or borrower for managing the borrower entity.
- j. Treatment of net operating income generated during construction:
 - (1) If the replacement cost mortgage (Criterion 3) is not the controlling mortgage, any NOI generated during construction may be applied to cover shortfalls in mortgageable soft costs, change orders, initial operating deficit and escrows. At final endorsement the balance of funds may be distributed to the borrower or deposited to the project's Reserve for Replacement account or applied toward the amortization of the mortgage principal.
 - (2) If the replacement cost mortgage (Criterion 3) is controlling the Mortgage Credit staff will do a calculation and determine if the interim NOI is equal to or greater than 1% of the original mortgage, if it is, the calculated interim NOI is deducted from the certified replacement cost amount. When the NOI does not meet this 1% threshold, apply the amount toward shortfalls, etc. as instructed in number 1 above. The Lender must deposit any remaining balance into the project's Reserve for Replacement account or apply it toward the amortization of the mortgage principal at final endorsement. There is no distribution to the borrower.
 - (3) For a non-profit mortgagor process:
 - (a) As a recovery of construction costs at cost certification, to the extent that it was used to reduce liquidated/actual damages.
 - (b) As an offset for a mortgage increase.
 - (c) Deposit the unused portion of net income into the project's Reserve for Replacement account at final endorsement.
- k. If operating expenses exceed income:
 - (1) No entry is made on Form HUD-92330, Mortgagor's Certification of Actual Cost.
 - (2) Operating deficit may be carried over as a reduction to net income on the supplemental operating statement.
- 6. A Certification by an independent Certified Public Accountant or an Independent Public Accountant must accompany Form HUD-92330, Mortgagor's Certificate of Actual Cost, including the audited balance sheet and operating statement of the borrower, and Form HUD-92330A, Contractor's Certificate of Actual Cost.

- a. The accountant must meet the auditor qualifications of the Government Auditing Standards (GAO Yellow Book), including the qualifications relating to independence and continuing professional education. The audit organization also must meet the quality control standards of the GAO Yellow Book.
 - b. Part 24 of Title 24 of the Code of Federal Regulations prohibits accountants from contracting for services when their name is shown on the HUD and General Services Administration Government-wide Consolidated List of Debarred, Suspended and Ineligible Contractors and Grantees.
 - c. The accountant must also comply with the requirements in Chapters 1, 2, and 6 of HUD Handbook IG 2000.4, "Consolidated Audit Guide for Audits of HUD Programs."
7. The borrower must submit a supplemental operating income statement if more than 3 months exist between the cut-off date and the start of amortization. If a deferment of amortization was granted, (Section 13.27) use the new date for the start of amortization in determining the need for a supplemental operating statement.
- a. This requirement does not apply to non-profit borrowers or any project where the mortgage is \$200,000 or less.
 - b. The statement covers the period from the cost certification cut-off date to the date, which is 3 months before the start of amortization. The borrower should submit the statement within 30 days after the expiration of this period.
 - c. If the required original cost certification was audited, a CPA or IPA must prepare and certify the supplemental statement.
 - d. The borrower may advance the date of amortization to avoid submitting a supplemental income statement.
 - e. In preparing the statement, if the operating statement submitted at cost certification shows expenses in excess of income, such expenses may be carried forward as "un-recovered expense—prior period."
- C. Section 223(f) Projects. The borrower must certify to the total costs incurred in the acquisition or refinancing of the property using Form HUD-2205-A, Mortgagor's Certificate of Actual Cost. The certification must be dated and signed by an authorized agent of the borrower. An accountant's opinion is not needed.
1. The certification must be submitted after all critical repairs have been completed, but at least 15 days before the desired closing date.
 2. The general contractor will be required to cost certify using Form HUD-92330A if a cost-plus construction contract is used.
 3. A balance sheet and income statement are not required.
 4. For cases involving deferred repairs, the borrower must submit a supplemental cost certification (Form HUD-2205-A) detailing the actual cost of the deferred repairs.

5. No cost certification is required for a 207/223(f) refinancing transaction where the mortgage is equal to or less than 80% of value at the time of issuance of the Firm Commitment.

13.13 Deficiencies in Cost Certification Submission

When the cost certification package is received for processing:

- A. The Cost and Mortgage Credit reviewers will:
 1. Determine deficiencies associated with the borrower's and contractor's cost certifications.
 2. Advise the Regional Center Director and estimate the time needed to resolve the problem(s).
 3. Attempt to resolve all problems by telephone before making a formal written request. This usually allows processing to continue while waiting for a formal reply.
 4. Send a letter within 5 workdays to the borrower with copies to the general contractor (if applicable), their accountants, and the lender stating the deficiencies and requesting information.
- B. Upon receipt of all necessary information, combined processing should not exceed 15 workdays.
- C. If the borrower or contractor indicates clarification will be forwarded within 5 workdays, the conclusions of cost certification can await the additional information.
- D. If not, issue Form HUD-92580.

13.14 Mortgage Credit Limited Review

- A. In cases where the borrower has not requested a mortgage increase, the HUD staff will:
 1. Review Form HUD-92330, Borrower's Certificate of Actual Cost. Adjust for items paid out of working capital and costs reflected on income statement.
 2. Review the reporting of:
 - a. Net income earned before the start of amortization. Report all income earned from the beginning of marketing and rent-up activities to the cut-off date for new construction projects and unoccupied substantial rehabilitation projects. For substantial rehabilitation projects where occupancy is continuous, report all income from the date of initial endorsement or, for insurance upon completion cases, the start of construction to the cut-off date. Make adjustments for ineligible reported expenses, such as depreciation.
 - b. The reporting of all grants/loans received for replacement cost items.

3. Complete Form HUD-92580, Maximum Insurable Mortgage, using the figures from Column C, Total, of Form HUD-92330. Complete the forms based on the most current instructions, except for the following changes:

- a. Line 2. Reflect the amount indicated in Column C of Form HUD-92330.
- b. Line 3. Explain any adjustments made to the net income or grant/loan amounts reported on Form HUD-92330.

NOTE: If adjustments are made to items other than net income and grants/loans, Form HUD-92331A, Cost Certification Review Worksheet should be completed.

4. When the borrower and the contractor submit their individual certificates of actual costs for review, they should have already agreed to the amount due the contractor. The amount due the contractor is reported on the certificates of actual costs and there should be no disagreement because all “to be paid items” will be listed on the HUD-92580, Determination of Maximum Insurable Mortgage, schedule 1, item by item. The Form HUD-92023, Request for Final Endorsement of Credit Instrument, must match the Maximum Insurable Mortgage, HUD-92580 minus whatever was paid in the interim. As mortgage credit performs the cost certification and prepares the HUD-92580, consider the follow when reconciling the certified costs:
 - a. After completion of the 92580 the Regional Center or Satellite Office notifies the lender/owner/general contractor (GC) of the balance in the line item for the GC, if there are issues then the Field will not move forward with the cost certification until all pending “to be paid items” are resolved.
 - b. The GC’s cost certification must balance with the items remaining to be paid.
 - c. Mortgage Credit must reconcile these numbers at cost certification, if there is a dispute all releases freeze until HUD/lender/GC come to agreement on who is owed what.
5. Report anything suspicious in the submission, (e.g. liabilities not disclosed during firm processing or before initial endorsement) to the Regional Center Director, who has the authority to request that a full cost certification review be completed. For such cases, complete Forms HUD-92331-A, and HUD-92580 based on the instructions in the MAP Forms Book, and Section 13.16, below. Also, if an accountant’s work is consistently deficient, warn the accountant that borrowers using their services will be advised that HUD will perform a detailed cost certification review.

13.15 Mortgage Credit Detailed Review

When a mortgage increase is requested of the Regional Center Director, a more detailed review is required. The HUD Underwriter will:

- A. Carefully review Forms HUD-92330 and HUD-92330-A if required for mathematical accuracy and compliance with prescribed procedures.

- B. Ensure that the submission contains required schedules and bills, which have not been submitted with previous draw requests, to support the certified amounts for interest, taxes, property insurance, HUD-FHA mortgage loan insurance premium (MIP), title and recording, financing fees, legal, organizational and audit fees, offsite costs and other fees.
- C. Require clarification or breakdown of all, or any part of, the cost figures presented by the borrower or general contractor, if applicable.
- D. Scrutinize any existence of an identity of interest subcontractor, material supplier or equipment lessor relationship.
- E. Review the notes and schedules attached to the accountant's opinion. Pay special attention to any liabilities included for repayment on the balance sheet that were not disclosed during the firm processing stage or before initial endorsement. These liabilities are not eligible for inclusion in the cost certification.
- F. Recommend that the Regional Center Director request an audit of the borrower's and/or contractor's books by the Regional Inspector General for Audit before issuing Form HUD-92580, Maximum Insurable Mortgage, when differences of opinion arise from other than:
 - 1. Honest differences of opinion clearly identifiable as such.
 - 2. Other justifiable causes.
- G. If considerable time has passed between initial occupancy and the cut-off date, some items properly allocable to renting and operating the project may be charged against construction cost.
 - 1. It may not be possible or practical to make precise allocation of such items as gas and electricity, clean-up costs, etc., between construction and operation periods.
 - 2. Insist on reasonable allocations and eliminate duplicate claims for the expenses under both categories.
- H. Advise cost staff of any construction costs included in "Miscellaneous" and "Other" categories of Form HUD-92330.
- I. Check items and amounts in the borrower's cost certification without auditing the borrower's books and records. An audit may be needed later. (Refer to Section 13.29)
- J. Record the results of the review (including NOI) on Form HUD-92331A, Cost Certification Review Worksheet.

13.16 Allowable Costs in Borrower's Certificate of Actual Cost

- A. Construction Contract:
 - 1. A lump sum construction contract is permitted when no identity of interest exists between the borrower and general contractor. The amount allowed in cost certification is the lesser of:

- a. Actual cash paid or to be paid by the borrower under the construction contract.
 - b. Contract price as adjusted by HUD's estimated cumulative effect of approved change orders paid, or to be paid, by the borrower and the liquidated/actual damages provision to the contract, if applicable.
2. A cost-plus construction contract is required when an identity of interest exists between the borrower and general contractor.
3. The amount allowed in cost certification when a cost-plus contract is used is the lesser of:
 - a. Actual cash paid, or to be paid, by the borrower under the construction contract, or
 - b. Amount the cost analyst allowed for construction on Form HUD-92331, Summary of Cost Certification Review–Cost Section, or
 - c. Contract price as adjusted by the HUD estimated cumulative effect of approved change orders paid, or to be paid, by the borrower and, if applicable, either the incentive provision or the liquidated/actual damages provision of the contract.

NOTE:

- (1) Recognize approved change orders necessitated by errors or omissions by the architect only to the extent there are savings in the mortgage. Do not recognize these change orders when processing a mortgage increase.
 - (2) Do not recognize approved betterment change orders in calculating the adjusted upset price in paragraphs A.1.b and A.3.c, above, unless they are determined by the cost staff to be necessary changes as defined in Section 12.8.
 - (3) Recognize the increase in general requirements, if any, noted on approved time extension change orders. Do not recognize increases in soft costs associated with the change order. The soft costs will be recognized under the applicable line items.
 - (4) When BSPRA is not applicable, for profit motivated projects involving an identity of interest between the borrower and general contractor, the amount of builder's profit as shown on Form HUD-93305M is eligible whether or not it was paid in cash.
 - (5) For non-profit borrowers, the allowable builder's profit is the lesser of the amount actually paid or to be paid in cash to the general contractor or the amount of builder's profit shown in Section G of Form HUD-92264, plus or minus any amount applicable due to HUD-approved change orders.
4. An identity of interest is construed to exist when:
 - a. There is any financial interest of the borrower in the general contractor or any financial interest of the general contractor in the borrower.

- b. Any officer, director, or stockholder or partner of the borrower is also an officer, director or stockholder or partner of the general contractor.
 - c. Any officer, director, stockholder, or partner of the borrower has any financial interest in the general contractor; or any officer, director, stockholder, or partner of the general contractor has any financial interest in the borrower.
 - d. The general contractor advances any funds to the borrower.
 - e. The general contractor supplies and pays, on behalf of the borrower, the cost of any architectural services or engineering services other than those of a surveyor, general superintendent, or engineer employed by a general contractor in connection with its obligations under the construction contract.
 - f. The general contractor takes stock or any interest in the borrower corporation as consideration of payment.
 - g. There exists any side deals, agreements, contracts, or undertakings entered into or contemplated, thereby altering, amending, or canceling any of the required closing documents, except as approved by the Secretary.
 - h. Any relationship (e.g. family) existing which would give the borrower or general contractor control or influence over the price of the contract or the price paid to the subcontractor, material supplier or lessor of equipment.
5. Incentive Fee Payments to Contractors.

The owner may request that the construction contract be modified before Initial Endorsement to provide for a general contractor incentive fee for completed construction work and delivering a completed project before the date specified in the construction contract (or as amended by HUD-approved time extension(s)). Incentive fees must be specified in an Addendum to the construction contract that has been approved by HUD before initial endorsement or at the execution of a construction contract that has been approved by HUD for Insurance Upon Completion and Insurance of Advance projects. An Incentive Payment Addendum may not be added to the contract after Initial Endorsement.

- a. Identity of interest borrower and general contractor.
 - (1) General contractor may benefit from savings in construction interest, taxes, property insurance, and mortgage insurance premiums to the extent there are construction cost overruns.
 - (2) Incentive payment is included in the adjusted upset price of the construction contract.

If there is an identity of interest between the borrower and the general contractor, an incentive fee may only be paid if there are certified cost overruns that were not included in a HUD approved change order, and the amount of the incentive fee may not exceed the amount of certified cost overruns that were incurred.

- b. Nonidentity of interest borrower and general contractor.
 - (1) Use Construction Contract Incentive Payment, Form HUD-92443.

(2) Include the incentive payment under “Other” on Form HUD-92331A.

Incentive fees must be calculated in accordance with Form HUD-92443. The incentive fee computed for Lump Sum construction contracts may not exceed 50% of the amount by which the estimated interest, taxes, property insurance and mortgage insurance premium, exceeds the certified costs for these same items through the actual date of completion.

The incentive fee computed for Cost Plus construction contracts may be paid in an amount calculated in accordance with the Incentive Payment Computation on page two of Form HUD-92443. Additionally, when the cost-plus contract is used the **contractor may not** receive total payments that exceed: (1) the actual costs of construction, (2) the cash fee provided in the construction contract, or (3) the incentive fee as determined by the computation. (The contractor shall not be paid an incentive fee that is greater than the amount of cost overruns; the contractor must only receive the amount of the incentive fee. Any excess of this amount must be refunded to the borrower.)

6. Damages Clause. Apply the damages clause of the construction contract when the general contractor does not complete the project on time. The clause holds the general contractor financially responsible for the added soft costs resulting from the contractor’s delay.
 - a. Calculate the amount of actual damages and liquidated damages, using the lesser to determine the adjusted upset price.
 - b. To determine actual damages, compute the actual cost of interest, taxes, insurance, and MIP for the period from the scheduled completion date (as amended by HUD-approved change orders) through the substantial completion date.
 - c. To determine liquidated damages, multiply the daily liquidated damages rate from the construction contract by the number of days between the scheduled completion date specified in the construction contract, as amended by the HUD-approved time extensions, through the substantial completion date.
 - d. Reduce the damages by the portion of the net operating income earned during the liquidated/actual damage period.
 - e. For those cases where an administrative completion date has been established, use this date for computing damages for cost certification purposes. However, the general contractor is responsible for damages through the date of substantial completion.
7. A borrower must be a single asset mortgagor entity and thus cannot act as its own general contractor, though there may be an identity of interest between the two parties.
8. Incomplete Minor Items. The borrower’s certification of the amount due under the terms of the construction contract may include the cost of minor items of on-site work that remain incomplete under the construction contract.

- B. Architect's fee(s) are limited to the amounts paid in cash.
1. Recognize the cost of additional services set forth in Article 10 of the Standard Form of Agreement between Owner and Architect for Housing Services, American Institute of Architects (AIA) Document B108 (see <https://www.aiacontracts.org/contract-documents/19711-owner-architect-agreement-for-a-federally-funded-or-federally-insured-project>). Ask Architectural and Cost staff to check the reasonableness of these charges.
 2. Disallow:
 - a. Any portion of the Architect's fee paid in stock.
 - b. Any costs associated with a clerk of the works.
 3. If any identity of interest comes into being between the Architect and either the borrower or general contractor during project construction:
 - a. See maximum design Architect's fee for cost certification purposes set forth in the Agreement and Certification, Form HUD-93305M.
 - b. Do not allow a fee for supervisory services to an identity of interest Architect.
 4. Treat any unused balance of the total Architect's fee as a direct mortgage reduction to the original mortgage amount on Form HUD-92580.
- C. Interest is allowable in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Section 13.8.
1. Recognize interest costs associated with an approved early start provided:
 - a. The borrower entered into an agreement with the contractor which:
 - (1) Was approved by the Regional Center Director.
 - (2) Agrees to reimburse the contractor for interest on money borrowed for construction prior to initial endorsement.
 - (3) States that reimbursement will be made only to the extent the borrower has funds available in the amount estimated for interest during construction.
 - b. The certified amount, when added to the interest cost incurred directly by the borrower, does not exceed the total amount of interest estimated in Section G of Form HUD-92264.

- c. Form HUD-92415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, was executed and approved.
 - d. Interest costs reflect the contractor's actual cost of money borrowed to cover the cost of construction between the early start date and the initial endorsement as adjusted by paragraph e., below.
 - e. Rate of interest does not exceed the rate established for the insured loan.
2. Interest rate paid on the construction loan cannot exceed:
 - a. For insurance of advances: the rate stated in the Firm Commitment.
 - b. For insurance upon completion: the rate acknowledged by the Regional Center Director before issuing the Firm Commitment.
 3. Deduct accrued interest forgiven by the lender or otherwise not paid in cash.
 4. Treat lender/bond underwriter's refund of any portion of the construction loan interest to the borrower or sponsor, as a direct mortgage reduction to the original mortgage amount on Form HUD-92580.
 5. If the construction interest rate changes before initial endorsement and it was not feasible to reprocess the project or if tax exempt bonds were sold to finance the construction loan and the true interest rate was not known until cost certification:
 - a. Interest savings may be created from the difference between the processed interest rate and the actual final interest rate.
 - b. Treat these savings as a direct mortgage reduction if the following condition was included in the Firm Commitment:

“Any interest savings resulting purely from a differential between the HUD processed interest rate and the actual construction interest rate may not be construed as excess funds that may be used to offset costs in other categories at the time of cost certification. Any such saving must be applied as a mortgage reduction.”
 6. Neither the interest on subordinated liens nor other obligations of the borrower are allowed as certifiable costs.
- D. Taxes are allowable in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Section 13.8. Do not recognize costs accrued during the early start period.
 - E. Property insurance is allowed in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Section 13.8. Do not recognize costs accrued during the early start period.
 - F. MIP. The FHA Comptroller's office cannot compute the exact amount of MIP due during the construction period until the project has been completed and the Washington Docket forwarded to Headquarters.

1. For a project involving insurance of advances, allow the higher MIP rate applicable to the specific FHA insurance program being used per annum on the mortgage amount on the basis of accrual for the number of days in the period used to Paragraph C above, when applicable.
 2. For a project involving insurance upon completion, no MIP is paid during construction.
- G. HUD application, commitment and inspection fees are allowable in the amounts paid. Fees paid to reopen an expired or terminated commitment are not allowable costs.
- H. Financing expense includes the initial service charge, discounts fees, Ginnie Mae commitment authority fees, permanent lender commitment fees, and other customary fees. Not eligible are financing expenses that are unusual or result from timing or delays, such as extension fees incurred for the lender's delivery of a mortgage-backed security.
1. Allow the lesser of:
 - a. Amounts paid, or to be paid, in cash.
 - b. Amounts shown on Form HUD-92434M, Lender's Certificate, or Certificate of Lender portion of Form HUD-92455M approved by the Regional Center Director before Initial Endorsement (Insurance of Advances) or issuance of Firm Commitment (Insurance Upon Completion).
 2. Construction lender's initial service charges (usually not more than 2%). Construction and permanent lenders' fees in the aggregate cannot exceed 3.5% (5.5% for bond financed projects) for Section 223(f) refinancing transactions and new construction or substantial rehabilitation transactions. The maximum fee for Section 223(a)(7) loans is 2% for loans greater than \$2 million, and up to \$40,000 for loan amounts less than \$2 million. The aggregate amount of origination, financing, and permanent placement fees must include the amount for lender's legal fee and is expected to cover the following:
 - a. Processing fees.
 - b. All expenses of the lender's counsel paid directly from the initial service charge. (Reconcile separate invoices or bills with the cost of the itemized figures.)
 - c. All other charges by the construction lender.
 - d. Excludes:
 - (1) Construction loan discount.
 - (2) Construction loan extension fees.

- e. Any charges made by the lender for payment of counsel services or charge paid directly to the lender's counsel, to the extent they cause the initial service charge to exceed 2 percent, are not certifiable. *Except*, if charges are related to "Title and Recording" expenses certify these under the same category, see Section 13.16.I below.
 - f. Lender's permanent placement fee is usually not more than 1.5%. It is expected to cover all permanent placement expenses, including lender's legal costs, but not discounts or some of the fees associated with a bond financed transaction.
 - g. If Ginnie Mae Mortgaged Backed Securities are involved, the lender may not assess an additional charge for the MBS application fee or for the custodial or delivery fee.
3. Recognize for cost certification:
- a. Reasonable discounts based on current interest rates at the time of issuance of the Firm Commitment for projects involving insurance of advances and insurance upon completion charged by the construction and permanent lenders. Construction loan extension fees are not earned until the time such extensions are granted. Recognize extension fees charged by the construction lender if funded at initial endorsement and shown on the Lender's Certificate, Form HUD-92434M.
 - b. Permanent loan fees and permanent loan extension fees, to the extent a separate permanent loan is anticipated, are earned at final closing. .
 - c. For Insurance Upon Completion cases, construction and permanent loan extension fees, to the extent a separate permanent loan is anticipated, are earned at final closing. The fee is shown in Statement C 2(h) and 2(i) of Form HUD-92455M.
 - d. Financing fees (including extension fees and discounts) paid on behalf of a borrower by a third party under Statements D 3(i) and 3(j) of the Lender's Certificate or Statements C 2(h) and 2(i) of Form HUD-92455M and shown as a current liability on the borrower's balance sheet to the extent there are savings in the mortgage. At final endorsement, require a promissory note be used for any unpaid balance of the obligation recognized in cost certification.
 - e. For bond financed projects, cost of issuance, discounts, and financing fees in excess of 5.5%; provided the cost certification evidences that the sponsor/borrower cannot benefit monetarily from excess investment income from the proceeds of the invested obligations. Refer to Section 8.15.
 - f. The Regional Center Director will inform the MAP Lender in writing of the aggregate amount that will be allowed at cost certification for discounts, financing fees and issuance costs. The allowed amount shall be reflected as a percentage of the mortgage loan. The amount of the fee is listed in the financing section of form HUD-92264 (or in an attachment thereto), which is a part of the Firm Commitment.
- The Lender will be required to acknowledge the additional costs, if any, that HUD will allow at cost certification by signing a copy of a letter from HUD to Lender detailing such costs. Such acknowledgement must be filed with form HUD-92434M in order to properly review the cost certification.
4. Do not recognize for cost certification:

- a. Any “side deals” (except for approved discounts) by which the borrower agrees to pay additional sums.
 - b. Discounts required to buy down the construction and/or permanent rate to a below market rate.
- 5. Treat the following as a direct mortgage reduction at final endorsement:
 - a. Premiums paid by lender to the borrower or sponsor for acquiring the construction or permanent loan.
 - b. Partial refunds of the Commitment fee allowed in processing, which are returned to the borrower or sponsor.
 - c. Discounts or other fees paid for by a contribution of a portion of the initial service charge by the lender/bond underwriter.
 - d. Rebates paid to a borrower or sponsor by the lender/bond underwriter for bond - financed mortgages.
- I. Title and recording expense are limited to cash paid for:
 - 1. Title search and policy at the time of initial endorsement;
 - 2. Recording fees at initial endorsement;
 - 3. Mortgage and stamp taxes;
 - 4. Survey recording fees;
 - 5. Updating title policy during construction;
 - 6. Final title policy and recording charges; and
 - 7. Legal fees incurred with any of the above.
- J. Legal, organization and audit expenses are limited to expenses incurred in organizing the borrower entity, developing the proposal to submit to HUD and other necessary governmental agencies and required services during closing and construction.
 - 1. Organizational allowance:
 - a. Allow only the amount included in Section G of Form HUD-92264 for the organizational fee, unless the borrower, who justifies the need for and reasonableness of the additional expenditure, submits fully supporting documentation.

- b. Any costs incurred in excess of this allowance are not eligible for recognition in processing a mortgage increase or the equity computation on Form HUD-92580.
- c. Do not allow:
 - (1) Expenses that are not directly identifiable with the proposed HUD insured transaction, i.e., predevelopment reports that were not prepared for the HUD insured loan.
 - (2) Expenses related to developing a larger development that includes the HUD insured parcel.
- 2. Limit the borrower's legal expenses to those incurred for: initial through final closings, tax advice during organization of borrower entity only, and preparation of documents and representation for and during organization of the borrower entity.
 - a. Allow customary expenditures expected to be incurred before and during initial closing, construction period, and final closing.
 - b. Do not allow:
 - (1) Expenses connected with land acquisition, that is already included in, or contributing to:
 - (a) Title and recording expense.
 - (b) Estimated market price of site.
 - (c) Obtaining changes in zoning.
 - (2) Cost of legal services to create tax shelters, trusts, etc.
- 3. Recognize cost of a "package deal" for organization and legal services provided:
 - a. Supplier is qualified to furnish the needed services.
 - b. Do not allow duplicate credit for the same services.
- 4. Audit fee covers the cost of the accountant's audit and opinion of the borrower's certificate of costs.
- 5. Amounts included in Form HUD-92264 for legal and audit expenses are not blanket allowances, but ordinarily set an upper limit on allowable amounts.
 - a. Non-typical fees must be borne by the borrower, unless in an exceptionally complex case, a higher fee is proven by the borrower to be necessary and reasonable. Detailed invoices and/or other documentation is required as to the reasonableness, purpose, necessity and proper classification of all items in the category.
 - b. This limitation is not flexible where a "package" for legal and organizational services is involved or where a substantial amount of the legal and organizational services is performed by the same firm.

K. Offsite Costs. Where the borrower enters into a supplemental contract for constructing offsite improvements, allow the lesser of:

1. Contract price as adjusted by HUD's estimated cumulative effect of approved offsite change orders.
2. Actual cash paid or to be paid for offsite work.
3. Amount allowed by cost analyst for offsite construction of Form HUD-92331, Summary of Cost Certification Review - Cost Section.

NOTE:

- a. The Valuation Branch must adjust the as-is land value of the property, if the allowed amount for offsite and demolition differs from HUD's estimate on Form HUD-92264 issued at Firm Commitment.
- b. Offsite costs are not allowable for leasehold estates when the ground rent is based on a land value that reflects all required offsite improvements since the borrower has not paid for those improvements.
- c. If the borrower certifies to off-site costs, the land value entered on Form HUD-92580, "Maximum Insurable Mortgage" will be reduced by the amount of off-site costs.

L. Other costs include all costs and/or recovery of costs which are not provided for elsewhere and which are clearly attributable to the actual cost of the project.

1. Cost of acquiring the leasehold interest provided the acquisition cost plus ground rent and offsite costs paid by the borrower, if any; do not exceed the HUD Fair Market Value of the Land Fully Improved. Any excess is to be reflected as a disallowed cost of acquiring the leasehold.
2. Ground rent paid during the period of the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date as defined in Section 13.8.
3. Incentive payment due a nonidentity of interest contractor for completing construction before the scheduled completion date as amended by HUD-approved change orders.
4. Compensation from an insurance claim including any income earned by investing the proceeds of the claim. Treat as recovery of cost after computing BSPRA.
5. Contractor's bond premium if paid by the borrower. If the construction contract contained an amount for the bond premium, subtract it from the contract amount when developing the adjusted upset price on line 1c of Form HUD-92331A.
6. Other fees, including engineering and topographical survey. Cost staff must determine if such costs are reasonable and not duplicated in the general contractor's costs.
7. Contingency reserve is included in the replacement cost of substantial rehabilitation projects.

- a. The contingency reserve may be used for unforeseen costs of necessary items and betterment change orders approved by HUD and unanticipated soft costs for time extensions approved by HUD.
 - b. Expenditures for change orders and shortfalls in soft costs should be certified to and allowed under those specific line items.
 - c. Normally there will not be an amount certified to under contingency reserve since all expenditures will be certified to on other line items.
 - d. An itemization of all expenditures covered by contingency reserve funds must be attached to the cost certification submission.
8. Grants, governmental loans or tax credit equity used to pay for allowed cost items.
- a. Should be treated as a recovery of cost after BSPRA.
 - b. Do not deduct grant, loan or tax credit equity funds from the total recognized costs when the funds were used to pay for the non-replacement cost items, i.e., used toward but not limited to: paying the acquisition cost of the land in excess of the HUD allowance, the operating deficit, working capital and items on Form HUD-2880, Applicant/Recipient Disclosure.
9. Residential relocation fund established on Form HUD-92264. Allow only those expenses approved by HUD up to the amount established on Form HUD-92264. Apply unused allowance as a direct mortgage reduction.
10. Third Party costs for appraisals, market analysis, PCNA etc., are no longer recorded in Other Fees and should be included with Organizational Cost line items (refer to Chapter 3).

M. BSPRA.

- 1. HUD does not control the division of BSPRA.
- 2. Compute BSPRA without regard to amounts on Form HUD-92264 based on a percentage of allowed costs.
 - a. Use the same percentage (not to exceed 10%) in the Firm Commitment review.
 - b. Exclude from the computation the cost of off-site work, land, payments for acquisition of leasehold, ground-rent, relocation expenses, and supplemental management funds, and Major Moveable Equipment, if applicable.
- 3. 50/75% rule.
 - a. Whether or not there is an identity of interest, no general contractor's fee (general overhead and profit) will be allowed when:
 - (1) More than 50% of the contract sum in the Construction Contract–Cost Plus, Form HUD-92442M, is subcontracted to one subcontractor, material supplier or equipment lessor, or
 - (2) 75% or more with three or less subcontractors, material suppliers and equipment lessors.

NOTE: If two or more subcontractors have any common ownership, they are considered as one subcontractor.

- b. Exceptions: The 50/75% rule is not applicable to:
 - (1) Manufacturers of Industrialized Housing.
 - (2) Trade items performed by persons on general contractor's payroll.
 - (3) Supplemental Loan program.
 - (4) Rehabilitation programs other than substantial rehabilitation.
- c. The cost analyst determines the applicability of the 50/75% rule.
- d. Where the 50/75% rule is violated, the general contractor forfeits its profit and only Sponsor's Profit Risk Allowance (SPRA) is allowed.
- 4. Where there is no identity of interest between the borrower and builder or when the 50/75% rule has been violated, compute an SPRA which is 10% of allowable:
 - a. Architectural fees.
 - b. Carrying charges and financing.
 - c. Legal, organization, and audit expenses.
- 5. If an identity of interest between the borrower and general contractor is established after initial endorsement and exists at the time of substantial completion, BSPRA is allowed in lieu of a builder's profit and SPRA.
- 6. If prior to the substantial completion date an identity of interest no longer exists between the borrower and builder, substitute SPRA for BSPRA.
 - a. The construction contract may be amended to permit a typical builder's profit.
 - b. Treat the difference between BSPRA and the combination of SPRA and builder's profit as a direct mortgage reduction on Form HUD-92580.
- N. Non-Profit Developer Fee. The allowable amount is included in the Firm Commitment less amounts certified and allowed on other line items.

13.17 Cost Review of Contractor's Cost Certification

- A. Actual costs are all costs, paid by the general contractor under the Construction Contract for completion of the project, and to which the general contractor certifies, using Form HUD-92330A.
 - 1. Include actual costs paid in cash, or to be paid in cash (such as items of delayed completion), within 45 days after the date of the substantial completion, for labor, materials, equipment, subcontract work, general requirements (job overhead), fees

and general overhead. Also include amounts estimated for any items requiring an escrow.

a. General Requirements:

- (1) May include salaries of clerical staff for time actually spent at the project site. Prorating of annual salaries on the percent basis is not permitted.
- (2) Salaries of executives may not be included in General Requirements. Such salaries are included in General Overhead.

b. General Overhead:

- (1) Include only the amount of the accepted Schedule of Values, Form HUD-2328, adjusted by the effect of approved change orders.
- (2) Itemization is not required.

2. Kickbacks, rebates, adjustments, discounts, or any other devices which the contractor may have received or is entitled to, must be deducted from actual costs.

B. For those cases where the borrower is not seeking a mortgage increase, or a detailed review is not requested by the Regional Center Director:

1. The cost analyst will not review Form HUD-92330A, Contractor's Certificate of Actual Cost, in assisting the Mortgage Credit Examiner in the analysis of the borrower's cost certification.
2. The cost analyst will advise Mortgage Credit Examiner of the approved change orders.

C. Cost Review

1. Conduct a detailed review when the borrower applies for a mortgage increase or the Regional Center Director orders a detailed review.
2. Review certifications where required from the contractor, or any subcontractor, equipment lessor, material supplier or manufacturer of industrialized housing.
3. Forms necessary to make reviews:
 - a. Form HUD-92330, Borrower's Certificate of Actual Cost.
 - b. Form HUD-92330-A, Contractor's Certificate of Actual Cost.
 - c. Form HUD-93305M, Agreement and Certification.
 - d. Form HUD-92437, Request for Construction Changes–Project Mortgages.
 - e. Form HUD-92326, Project Cost Estimate (HUD Estimate).
 - f. Form HUD-2328, Contractor's and/or Borrower's Cost Breakdown.
 - g. Form HUD-92331-B, Cost Certification Review Worksheet.
 - h. Form HUD-92331, Summary of Cost Certification Review.
 - i. Form HUD-95379, Trip Report.
4. Steps to conduct the review:

- a. 50/75% rule check. Use information from the “total” and “name of subcontractor or payee” columns of the general contractor’s cost certification. If the rule applies, disallow the general contractor’s general overhead and profit. If the project uses BSPRA, disallow only the general overhead and inform the Mortgage Credit Examiner.
- b. Identity of interest subcontract review (for borrower, general contractor, subcontractors, equipment lessor, material suppliers, and industrialized housing manufacturers):

- (1) Examine Form HUD-93305M and Form HUD-92330-A to establish all declared identities of interest.
- (2) Review each identity of interest subcontractor’s cost certification.

NOTE: If cost certification not received, disallow subcontractor’s overhead, profit, and all questionable costs.

- (a) If no prior approval as an identity of interest subcontractor, disallow subcontract overhead and profit.
- (b) For prior approval:
 - (i) Allow prior approved subcontract overhead and profit, plus or minus the effect of approved change orders. Disallow excess.

NOTE: Do not reduce the prior approved subcontract overhead and profit in the event that the certified cost for the work is less than the prior approved maximum subcontract price.

- (ii) Allow up to the prior approved maximum subcontract amount for work, plus or minus the effect of approved change orders. Disallow excess.

5. Trade line item review:

- a. On Form HUD-92331-B.
 - (1) Enter all trade line costs from HUD estimate (Form HUD-92326) or Contractor’s schedule of values (Form HUD-2328) after adjusting for approved change orders.
 - (2) Enter all trade line costs from general contractor’s cost certification (Form HUD-92330-A). Take architect’s fees from borrower’s cost certification (Form HUD-92330).
 - (3) Using dollar and percentage variance columns compare each trade’s actual cost with the estimate. Determine allowable amounts.
- b. Allowable amounts are not limited by the estimates. Analyze differences.

- (1) Allow actual costs paid to complete the work in accordance with the construction contract.
 - (2) Allow actual costs due to unusual circumstances, e.g., subcontractor bankruptcy, code changes, required replacement of completed work, replacements due to natural occurrences (storms, floods, earthquakes, etc.).
 - c. Question only amounts substantially in excess.
 - (1) Contact general contractor and/or borrower requesting explanation or more documentation.
 - (2) Make disallowances if explanation/documentation is not received in a reasonable amount of time.
 - (3) Only the accountant may make reallocation of monies from one trade item to another.
 - (4) As a result of discussion, have the accountant amend Form HUD-92330-A and resubmit.
 - d. Disallow any amount not justified or supported as being part of the construction contract work.
 - e. Disallow costs for duplication of work due to contractor's error or negligence, e.g., improper placement, failure to protect, noncompliance with contract, etc.
- D. Summary of Cost Certification Review on Form HUD-92331.
- 1. Enter all recommended disallowances.
 - 2. Enter summary of construction contract costs.
 - 3. Enter contractor's profit from borrower's Form HUD-92330. Add profit from all HUD approved change orders.
 - 4. Enter offsite costs from borrower's Form HUD-92330, if applicable.
 - a. Review itemized offsite breakdown.
 - b. Disallow any cost duplication on general contractor's Form HUD-92330-A.
 - 5. Property Insurance Schedule, Form HUD-92329. Complete new form using allowed construction costs.
- E. Lump Sum Construction Contract Cost Certification.
- 1. Review borrower's certification (Form HUD-92330) if requested to do so by Regional Center Director.
 - 2. Review cost certification of any subcontractor that has identity of interest with the borrower.

13.18 Determination of the Non-profit Borrower's Initial Equity Investment

The Non-profit borrower will be permitted a 6% return on its initial equity as computed on Form HUD-92580, Maximum Insurable Mortgage.

A. The base equity is determined as follows:

1. New Construction: Line 6, Form HUD-92580, minus finally endorsed mortgage determined in line 10 of the form.
2. Rehabilitation–Property Owned: Reduce the sum of line 4, Form HUD-92580, plus HUD's estimate of the "as is value" of the existing land and improvements before rehabilitation, by the finally endorsed mortgage determined in line 10 of the form.
3. Rehabilitation–Property Acquired: Reduce the sum of line 4, Form HUD-92580, plus the lesser of HUD's estimate of the "as-is value" of the existing land and improvements before rehabilitation or the acquisition cost of the property, by the finally endorsed mortgage determined in line 10 of the form.
4. Rehabilitation under Section 220 and 221(d)(4): Use the New Construction formula in paragraph A.1 above.

B. The base equity computed in paragraph A.1 above may be increased by:

1. The cost of furnishing, fixtures, equipment or other necessary items and betterments essential to the operation of the project.
2. The non-profit developer's fee used to reduce the estimate closing costs of the project.
3. Grants from national, regional, and local community service organizations (non-government source).
4. Sponsor's cash contribution for the cost of land over and above what HUD has allowed.

C. Modify the Regulatory Agreement to require the return on equity be used for:

1. Continued affordable housing initiatives; or
2. Pledged to the repayment of surplus cash or residual receipts notes held as secondary financing.

D. Asset Management will monitor the non-profit borrower to be certain that the return on equity is used only for permissible purposes.

E. The return on equity is paid from surplus cash/residual receipts. Any shortfall in the permitted return in one year may be made up from surplus project funds in a future year.

13.19 Determine the Borrower's Initial Investment

- A. New construction and substantial rehabilitation projects under Sections 220 and 221(d)(4): Line 6, Form HUD-92580, minus the maximum insurable mortgage determined in line 10 of this form.
- B. The amount determined by above Paragraphs A may be increased by:
 - 1. Expended working capital funds not recognized in the cost certification review.
 - 2. Residential relocation expenses approved by HUD in excess of the amount established on Form HUD-92264, Section G, and Section O, Remarks and Conclusions.
- C. Distributions (per the Regulatory Agreement, Form HUD-92466M). Mortgagor or any Affiliate or Principal shall not make, receive or retain any distribution of assets or any income of any kind from the project, except from Surplus Cash. This limitation does not apply to interim income generated during construction, but project income as it relates to the surplus cash calculation.

13.20 Section 223(f) Modified Form of Cost Certification

- A. HUD shall complete and submit a modified form of cost certification for review 15 days before the initial/final endorsement of the loan for insurance for all projects processed pursuant to Section 223(f); except those 207/223(f) refinancing transactions where 80% or less of value is the controlling criterion. (In such case cost certification is not required.) Unlike other cost certification procedures, savings from one-line item cannot offset cost overruns on another line item. HUD completes the cost certification and if there is a cost savings, HUD must recalculate the maximum insurable mortgage. Refer to Form HUD-2205-A's instructions.
 - 1. The borrower must certify to the total actual costs incurred in the acquisition or refinancing of the property. The certification must be submitted on Form HUD-2205-A, and it must be dated and signed by an authorized agent of the borrower.
 - 2. The lender must submit the certification to HUD for computation of the maximum insurable mortgage and completion of Section II of Form HUD-2205-A.
 - 3. If, in a purchase transaction, the amount of the acquisition cost determined allowable at cost certification exceeds the estimate of value, that was determined during processing, the rent formula shall be recomputed. This re-computation may be accomplished using the allowable acquisition cost as determined by cost certification and the dollar amount of secondary financing represented by the approved promissory notes (Form HUD-92223).

- B. The borrower must submit 15 days after repairs are complete, a supplemental cost certification for deferred repairs for an escrow that was established at initial/final endorsement to complete non-critical repairs. In cases where the actual costs are less than estimated, you must recalculate the maximum insurable mortgage. If the maximum insurable mortgage is reduced based upon this recalculation of the lower actual costs, the borrower must either:
1. Have the required prepayment deducted from the repair escrow, or
 2. Deposit proceeds into the project's replacement reserve account, or
 3. Provide the required prepayment to the lender.

13.21 Special Instructions for Substantial Rehabilitation

NOTE: Cost certification instructions (set by statute) dictate that the lesser of the “as is” value of the land and improvements (before repair or rehabilitation) or the purchase price of the land and improvements, is used in the cost build up for Criterion 3 of Form HUD-92264-A, in substantial rehabilitation cases. Consequently, when mortgage proceeds will be used to fund the acquisition of the property, the “as is” value estimation will be used as a test of the reasonableness of the acquisition price.

When the acquisition price is less than the “as is” value of the land and improvements (as accepted by HUD), and mortgage proceeds will be used to fund the acquisition of the property, the acquisition price will be used in the cost build up for Criterion 3 forming the cost basis for the Firm Commitment.

When the acquisition price exceeds the “as is” value of the land and improvements (as accepted by HUD), and mortgage proceeds will be used to fund the acquisition of the property, then the “as is” value will comprise the basis of the cost build up for the Firm Commitment.

When mortgage proceeds will not be used to fund the acquisition of the property, the “as is” market value of the property will be used in the cost build up for Criterion 3 forming the cost basis for the Firm Commitment. This is particularly significant when below market rent restrictions (such as in the case of LIHTC limited rents or Section 8 rent subsidy) are in place and the use of market rents in valuing the property will result in a premium over these rent restrictions. (See Section 7.13.C, on defining how rents are derived as the basis for the “as is” value).

13.22 Mortgage Reduction after Cost Certification

- A. The National Housing Act requires that the mortgage will not exceed the applicable percentage of actual costs. If certified actual costs are lower than original projected cost as reflected in Form HUD-92264, a reduction in mortgage may be applicable. The Agreement and Certification, Form HUD-93305M, also addresses this issue and provides that where HUD accepts, for cost certification, estimates of cost for any item, the later substitution of certified actual costs may require a reduction of the mortgage.

- B. Reductions of cost may arise from:
1. Refunds, rebates, or discounts.
 2. Excess of escrows over the actual costs of incomplete construction items.
 3. Refunds of deposits made by the borrower to prevent losses to the lender from loss in connection with sale of the mortgage.
 4. Settlement of claims against bonding companies or others after project completion.
- C. At final endorsement the borrower must set up a **cash escrow** to pay all "to be paid in cash items" identified on Form HUD-92330, Borrower's Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid, on Form HUD-92330.
1. Reconcile the difference between:
 - a. Obligations listed on Form HUD-92023M, Request for Final Endorsement of Credit Instrument or HUD-92455M (for Insurance Upon Completion Projects only), and
 - b. The "to be paid" column on Form HUD-92330 plus debts to third parties.
 2. Paid receipts to third parties must support differences and a statement from the borrower identifying by name and cost, those items paid in cash. The receipts and statement are affixed to Forms HUD-92023M or HUD-92455M.
 3. Do not accept personal or business checks issued by the borrower at final endorsement as evidence of payment. Payments to third parties must be in the form of a certified or cashier check.
 4. Prepare a new Form HUD-92331A to disallow obligations listed as "paid" or "to be paid" on Form HUD-92330, which are represented at final endorsement as paid by HUD-approved notes. Prepare a new Form HUD-92580 from the total of HUD-approved cost of revised Form HUD-92331A.
 5. Undisbursed mortgage proceeds may supplement or satisfy the cash escrow for all "to be paid in cash items".
 6. Use Form HUD-92476.1M, Escrow Agreement for Non-Critical, Deferred Repairs:
 - a. To set up the cash escrow for all "to be paid in cash items".
 - b. Attach a detailed listing of the unpaid costs.
 7. Use Form HUD-92464M, Request for Approval of Advances of Escrow Funds to disburse escrow.
 8. Escrow should be disbursed within 45 days after final endorsement. If all the funds are not disbursed, follow the sixty days after final endorsement procedures in Section D below.
 9. At final endorsement if all obligations have been paid in cash, this completes the process.
- D. Sixty days after final endorsement:
1. Prepare a new Form HUD-92331A. Enter under the column heading:
 - a. "92264" - the amount of each item of cost recognized from the earlier Form HUD-92331A "Allowed" column.

- b. "92330/92330A" - the amount listed in Column C of the Borrower's Certificate of Actual Cost, Form HUD-92330, for each item of cost.
 - c. "Allowed" - the amounts paid in cash based on the reconciliation performed in Section B above and disbursements from the cash escrow account.
 - d. "Disallowed" - the lower of the amounts previously allowed or paid in cash.
- 2. Compute a new Maximum Insurable Mortgage, Form HUD-92580, based on the total of the "Disallowed Column" (Form HUD-92331-A). If this computation produces an amount less than the mortgage finally endorsed:
 - a. Notify the Directors of Housing Production and Asset Management (OAMPO) by memorandum that prepayment to the mortgage is required.
 - b. Prepayment is mandatory and is applied:
 - (1) In amounts equal to the scheduled monthly principal payments, to the extent possible.
 - (2) Any remainder goes to the Reserve for Replacements Account.
 - c. If HUD is notified that payment has been delayed because of a dispute or litigation, retain funds to pay the amount pending resolution of the dispute.
 - d. Notify the lender or escrow agent by letter (Director of Housing Production) of the required prepayment.
 - e. Control the remaining balance in a special account, as a reserve for unpaid construction costs from which disbursements may be made only after written consent of the Regional Center or Satellite Office.
- 3. The lender will continue to use the existing amortization schedule for servicing the mortgage.
 - a. The prepayment is in addition to the regular monthly payments to principal.
 - b. There is no adjustment in the amount of the annual MIP due because of these mandatory prepayments.
- 4. The escrow requirement does not apply to funds the general contractor owes. However, the general contractor must submit a reconciliation of its "to be paid" items, such as Form HUD-92330A.

13.23 Increase in Mortgage Amount

- A. Timing. Requests for a mortgage increase will not be considered until the project is complete, cost certification has been submitted, and the Final Endorsement will likely be achieved immediately following processing of the mortgage increase and the conditions in paragraph B below are met.
- B. Bases for considering a mortgage increase:

1. Necessary changes that arise from differing site conditions (as defined in the construction contract).
2. Compliance with local codes.
3. Unforeseen conditions that might affect the safety and health of occupants.
4. Betterment changes that are economically justified as determined by HUD e.g., those that can be documented to produce significant cost savings to project operation, increase income expectancy, or enhance the security of the mortgage.
5. Costs caused by extensions in construction time, when such extensions are approved by HUD; justifiable under AIA General Conditions; and caused by problems beyond the contractor's control. Other costs not known at Firm Commitment resulting from requirements of local authorities and beyond the borrower's control.
6. Construction hard cost increases caused by a natural disaster declared by Federal or State government, to the extent not covered by casualty insurance.
7. Increased costs resulting from concealed subsurface site conditions, provided it is determined those exploratory tests during project design were sufficient and thorough and neither the architect nor engineer was at fault.
8. Cost of substituting a general contractor when the original general contractor is terminated for cause and the surety has failed to perform.
9. To correct a substantial HUD error in the original processing that would otherwise result in serious inequities.
10. Any mortgage increase for an insured project must be in an amount greater than 2.5% of the original mortgage or \$400,000.

13.24 Restrictions on Mortgage Increases

- A. A mortgage increase may not be granted for cost overruns associated with completion of the work in accordance with the original contract documents by the original contractor, changes made primarily for the convenience of the borrower or contractor, nor for the aggrandizement of the borrower or contractor. B. Cost overruns are not a basis for granting a borrower's request for mortgage increase nor are changes made primarily for the convenience or aggrandizement of the borrower or contractor. C. Any mortgage increase for an insured project must be in an amount greater than 2.5% of the original mortgage or \$400,000.

- D. The increase must be supported by net income under Criterion 5 of Form HUD-92264-A as determined at initial endorsement.
- E. A mortgage increase may not be granted for replacing a contractor where the borrower sets up a “straw contractor” for purposes of BSPRA.

13.25 Processing a Mortgage Increase

Technical processing consists of Step One through Step Four below. The four steps to processing a mortgage increase, depending on the bases for the increase being considered:

- A. Step One: Use the alternative applicable to the basis for the increase being considered are:
 - 1. Alternative One, applicable to necessary items and betterment change order cost increases:
 - a. HUD Construction Analyst and Valuation staffs review the change orders to determine eligibility for processing a mortgage increase. Architecture further reviews for the added cost.
 - b. HUD Underwriter computes the allowable costs on Form HUD-92331-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.d. Reduce this amount by the cost attributable to any change order(s) not qualifying for a mortgage increase.
 - c. The adjusted hard cost forms the basis of the mortgage increase computation.
 - 2. Alternative Two, applicable to contract time extension soft cost increases:
 - a. HUD Underwriter computes the allowable costs on Form HUD-92331-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Lines 3 through 6.
 - b. The adjusted soft cost forms the basis of the mortgage increase computation.
 - 3. Alternative Three, applicable to construction contract cost increases due to a change in the contractor:
 - a. HUD Construction Analyst computes a new Form HUD-2328 and Form HUD-92264, Section G through Line 50.
 - b. HUD Underwriter computes the allowable costs of Form HUD-92331-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.c. for hard cost increases between the original contractor and the contractor completing the work, and Lines 3 through 6 for soft cost increases associated with the change in contractor.
 - c. The adjusted hard and soft costs form the basis of the mortgage increase computation.
 - 4. Alternative Four, applicable to substantial error in HUD cost processing:

- a. The HUD Construction Analyst completes a new Form HUD-2328, and Form HUD-92264, Section G through line 50.
- b. Underwriter computes the allowable costs on Form HUD-92231-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.c, using the criteria in paragraph c. below.
- c. The allowable construction costs for processing the increase will be based upon the lesser of:
 - (1) The amount of the construction cost certified by the borrower, or
 - (2) The upset price of the construction contract as adjusted by approved change orders eligible for a mortgage increase, plus the increases resulting from correcting or errors in the original processing.
- d. The adjusted hard cost forms the basis of the mortgage increase computation.

NOTE: The mortgage credit underwriter must not use the adjusted upset price of the construction contract as a limiting criterion, where there is a substantial error in HUD cost processing.

B. Step Two: HUD Underwriter must compute (for use by Valuation in completing Form HUD-92264) the eligible costs and fees for the following: architect's fees, bond premium if paid by the borrower, other fees not included in the construction contract and paid by the borrower, interest, taxes, the mortgage insurance premium, developer's fee (if applicable), legal, organizational and audit fees, marketing (if applicable), offsite costs, as-is land value and "as-is" value of property (if applicable). HUD Underwriter must comply with the following in computing the costs and fees.

1. Do not increase BSPRA or restore Contingency Reserve or non-profit's Developer's Fee.
2. Do not include non-mortgageable items (construction or permanent loan extension fees; discount rate, maintenance fees, etc.)
3. Offset non-mortgageable items by net interim income (net non-proprietary income, if applicable) to offset amount of mortgage increase, and
4. For increases caused by natural disaster:
 - a. Consider in the revised cost any increases from any interim closing for: carrying charges, financing fees, and legal fees. Do not include any cost due to construction delays before the disaster,

- b. Cut the new estimated replacement cost by the amount of any actual recovery through insurance proceeds, and
 - c. Require prepayments to be made for any late recovery of insurance proceeds.
- C. Step Three. Valuation must use the costs and fees developed by HUD Underwriter in Step Two in revising Form HUD-92264. Valuation must consider each of the following:
 - 1. Examination fee, initial service fee, Ginnie Mae fee, inspection fee, MIP, and title and recording based on the approvable increased mortgage amount.
 - 2. Net income derived from market rent, expense and occupancy estimates current as of the date of mortgage increase processing.
- D. Step Four. HUD Underwriter must prepare a revised Form HUD-92264-A, using the revised Form HUD-92264 and Trial Form HUD-92264-A prepared by Valuation in Step Three.
- E. Preparation of Modified Form HUD-92580 for a Mortgage Increase.
 - 1. Add on Line 1(d) Other: “ADD Mortgage Increase” and enter the amount of the approved increase as an amount rounded to an even \$100.
 - 2. Include a condition in Schedule 1 requiring the modification of the mortgage at final endorsement.

13.26 Authorization to Reopen Mortgage Transaction

- A. HUD must advise the lender of its approval or denial of the request for a mortgage increase upon completion of technical processing. Use Specimen Letter–Agreement Authorizing Reopening of Mortgage Transaction (Appendix 13A), to notify the mortgagee, where a determination is made to increase the mortgage.
 - 1. Approval of a mortgage increase is subject to the payment of the following fees based on the amount of the increase.
 - a. Application Fee of \$3.00 per thousand of the increase.
 - b. Inspection Fee of \$5.00 per thousand of the increase is applicable only when the increase involves construction hard costs.

13.27 Deferment of Principal Payments

Borrowers are expected to manage the construction period and fulfill the payment terms of the mortgage note without modification. However, certain uncommon circumstances that result in delays in construction or achieving sustaining occupancy may justify a deferment of principal payments (e.g. delay in the commencement of amortization).

Sufficient justification may exist after a casualty loss or catastrophic event (e.g. hurricane, flooding etc.) or other significant non-borrower related delays to support a deferment, however general delays from normal inclement weather, labor/material shortages, or other typical construction related exigencies would likely be insufficient justification for HUD to approve the deferment request.

Should a MAP lender request a deferral in principal payment, the following conditions must be met:

- A. Securitized Loan Requirements. If the loan is collateral for a Ginnie Mae mortgage-backed security, then Ginnie Mae's written acknowledgement that it is acceptable to delay principal payments via a loan modification is required. The MAP lender must contact Ginnie Mae, Office of Issuer and Portfolio Management, Multifamily Division for review and approval.
- B. FHA Request Requirements.
 - 1. Justification that conforming to the existing amortization schedule is an unreasonable hardship and would increase risks to HUD.
 - 2. Written assurance by the owner confirming that sufficient funds exist outside the mortgage proceeds to pay any interest overrun.
 - 3. The borrower can evidence reasonable effort to complete construction and attain sustaining occupancy on a timely basis;
 - 4. The period of deferment is limited only to the additional time necessary for the borrower to stabilize project operations.
- C. Deferment Letter. Use Appendix 13B, Specimen Letter – Agreement Authorizing Deferment of Principal Payments for Level Annuity Monthly Payment and distribute copies in accordance with Section 13.28 below.
- D. Deferment Instruments. The Regional Center Director is authorized to approve modifications of the principal and interest payment as may be necessary to affect the deferment of principal payments.

13.28 Document Distribution

- A. Form HUD-92580, Maximum Insurable Mortgage.
 - 1. Lender—original and one executed copy.
 - 2. One executed copy to each of the following: Closing Attorney, Mortgage Credit Control File, Washington Docket, Regional Center or Satellite Office Docket, Regional Center or Satellite Office
- B. Cost Certification Documents. Original documents filed in the Washington Docket and one copy in the Regional Center or Satellite Office Docket.

13.29 Office of Inspector General

The Regional Center Director should refer borrowers to the Office of Inspector General to evaluate the borrower's and/or contractor's books where discrepancies appear to arise from other than inadvertent error, or creditable misinterpretation of applicable criteria. Do not issue Form HUD-92580, Maximum Insurable Mortgage, before completion of an OIG audit or investigation initiated before its issuance. A referral must also be requested for any indicated fraud or material misrepresentation detected after issuance of Form HUD-92580.

13.30 Cost Certification Incontestability

After HUD approves the certifications and issues Form HUD-92580, Maximum Insurable Mortgage, they are final and incontestable unless there is fraud or material misrepresentation by the borrower, general contractor, or subcontractors.

13.31 Post Closing Escrows

Post-Closing Escrows must be set up at final closing to pay all “to be paid in cash” items identified on Form HUD-92330, Borrower's Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid on Form HUD-92330. These amounts may be adjusted for payments made between the cut-off date and the date of final closing.

13.32 Final Closing – Insurance of Advances

13.32.01 Amortization and Mandatory Prepayments

- A. Advance Amortization Requirements. “Advance amortization” is the requirement that, to the extent that the project generates net operating income during the Accountability Period (defined in the next paragraph), HUD may require Borrower, prior to final endorsement, to make, or to agree to make, a prepayment to principal in the amount of

such net operating income, all as discussed more fully in sub-section C below. In order for the Regional Center Director to determine whether or not advance amortization is required, Borrower must account for all operating income for the period ending three months prior to the originally scheduled date of the first principal payment under the mortgage loan (*e.g.*, through June 30 if first principal payment is scheduled for October 1).

B. Income and Expense Statement Requirement. In connection with cost certification, Borrower will already have reported the results of occupancy during the cost certification period. Therefore, when more than three months intervene between the cost certification period and the first principal payment as originally scheduled, the Regional Center Director will require an income and expense statement covering the period beginning at the end of the cost certification period and ending three months prior to the date of the first principal payment under the mortgage loan as originally scheduled (the Accountability Period).

1. Agreement of Borrower. When final closing is scheduled to occur before the expiration of the Accountability Period, Borrower must agree in writing, as an inducement to HUD to approve the final disbursement of mortgage loan proceeds prior to the expiration of the Accountability Period, to:
 - a. Furnish an income and expense statement for the required period within 30 days after its expiration, and
 - b. Immediately apply, as a mandatory prepayment to the mortgage loan, such portion of the net operating income as HUD may require.
2. When final closing is scheduled to occur after the close of the Accountability Period, the income and expense statement shall be submitted prior to final closing.
3. Treatment of Items in Statement. In the preparation of the income and expense statement, Borrower must include as income all rents received, exclusive of security deposits. All expenses for operation, including taxes, insurance, HUD-FHA mortgage loan insurance premium (MIP), interest and reasonable management fees (but not officers' salaries or depreciation), may be deducted in determining net income for this purpose. If the cost certification reveals an excess of expense over income, such excess (to the extent recognized by HUD) may be carried forward to the statement required by this paragraph as "unrecovered expense prior period."

C. Amount of Required Prepayment. The amount and handling of the prepayment required is subject to the following:

1. In no case shall the required prepayment exceed the amount which would have been due in cumulative principal payments if the first scheduled payment had been on the first of the month in which the Accountability Period started.

2. Prepayment will be required only to the extent that the amount of the net income permits payment of one or more full monthly principal payments as scheduled.
3. If the circumstances are such that the operating statement is submitted before final endorsement, Lender and Borrower may elect to have the mortgage loan endorsed for less than the face amount by a sum equal to that which would have been required as mandatory prepayment, provided such action is acceptable to Ginnie Mae.

D. Excess (Unused) Mortgage Loan Proceeds.

1. In circumstances where the cash paid out for completion of the project is less than the mortgage loan proceeds, the Regional Center Director shall require that any part of the mortgage loan proceeds that have not been expended to pay necessary costs of completing the project shall be deposited in the reserve for replacement account of the Borrower, from which disbursements may be made only with the prior written consent of the Regional Center Director. This requirement is stated in form HUD-93305M, *Agreement and Certification*, at paragraph 3. Where the Commissioner requires the mortgagor to make a deposit of cash, such deposit shall be with mortgagee or a repository acceptable to the mortgagee. The deposit shall be held by the mortgagee in a special account or by the depository under an appropriate agreement approved by the Commissioner.
2. The establishment of the fund can be avoided by an immediate reduction of the mortgage loan at closing, before establishment of the amortization schedule.
3. The Regional Center Director will approve or disapprove the use of the funds for purposes other than reduction of the mortgage loan.
4. If the mortgage loan proceeds exceed the cash paid out for completion solely because there is a difference between the purchase price of land for a period of years and its "fair market value" in fee simple and "as is", as determined by HUD, the Regional Center Director may waive this requirement. The request for waiver shall be accompanied by full information as to the date of purchase and the purchase price of the land.

13.32.02 Confirmation of Final Loan Amount

A. Preparation of form HUD-92580, *Maximum Insurable Mortgage*.

1. Prior to final endorsement, the Regional Center Director shall execute form HUD-92580, *Maximum Insurable Mortgage*, for the purpose of indicating to Lender and Borrower whether or not a reduction in the original amount of the Loan is necessary, based either upon the cost certification or upon a request by Lender for a principal increase. The Regional Center Director will receive, review, and accept certificates of actual cost and form HUD-95379, *Final HUD Representative's Trip Report*, prior to completing form HUD-92580.

2. If there is any change in the loan amount, form HUD-92580 also will recite the revised amount of the Level Annuity Monthly Payment (LAMP).
3. Upon execution of form HUD-92580, the original shall be forwarded to Lender and an executed copy shall be forwarded to Borrower. One copy shall be placed in the Washington Docket with copies of the cost certification exhibits and one copy, unless stored electronically, will be placed in the field office docket
4. Copies of both form HUD-92580 and form HUD-95379 also shall be forwarded to the HUD Closing Attorney for use in preparing for final endorsement.

B. Decrease in Loan Amount:

1. If HUD's review of the cost certification results in a decrease in the Loan amount, which decrease would be set forth in form HUD-92580, Lender must, subject to local practice, prepare and submit the following items to HUD, prior to final endorsement, to modify the Security Instrument amount and the LAMP amount accordingly.
 - a. A proposed Modification Agreement, in a form acceptable to HUD (see requirements in Part 2 of the Closing Guide) and,
 - b. As applicable, a proposed Allonge, in a form acceptable to HUD (see requirements in Part 2 of the Closing Guide).
2. The final endorsement for insurance shall be in the lesser loan amount.
3. If a small loan decrease is involved, and Borrower does not request a change of amortization, a notation may be made on the Note indicating that the mortgage loan amount is reduced without a change in amortization. In this case, the finally endorsed amount will reflect the reduced principal balance.
4. Any reduction in the original principal amount of the loan that may be required by HUD as a result of cost certification shall not be construed as a prepayment of the mortgage loan.

C. Increase in Loan Amount.

1. If the Regional Center Director approves an increase in the mortgage loan amount, as reflected in form HUD-92580, Lender must include the following items in the package of draft closing documents submitted to HUD for final endorsement to evidence the obligation to repay the amount of the increase and to consolidate the initial and supplemental documents:
 - a. Supplemental Note.
 - b. Supplemental Security Instrument.
 - c. Modification and Consolidation Agreement.

- d. Supplemental Borrower's Attorney's Opinion (as to the foregoing three documents).
 - e. Updated title policy insurance amount.
2. The requirements for these documents are discussed in Section 2.10.D of this Closing Guide.

D. Statement of Status of Escrows. Form HUD-92580 shall also:

- 1. Show the status of all escrow accounts that were established by Borrower at initial closing; and
- 2. Indicate whether, based on the final form HUD-95379, *HUD Representative's Trip Report*, an escrow for unpaid construction costs appears necessary. See discussion concerning incomplete facilities, at Section 1.9 and Section 1.10 of this Closing Guide, above.

E. Borrower's Investment.

- 1. The amount of Borrower's initial equity investment is to be determined by the Program Staff in accordance with the MAP Guide. Once this determination has been made, the Regional Center Director will immediately notify Borrower in writing as to the amount of the initial equity investment. A copy of such determination shall be attached to each copy of form HUD-92580. For new construction and substantial rehabilitation projects, equity is determined by subtracting the finally endorsed mortgage loan amount from the amount on line 6, form HUD-92580.
- 2. To the base amount of the final mortgage loan, as determined above, there may be added certain cash outlays for furnishings, equipment, or other betterments essential to the operation of the project. The nature and extent of such outlays shall be substantiated by a supporting schedule in a manner satisfactory to the Regional Center Director. The schedule shall set forth the vendor's name, a description of the item or items purchased, the total price, and the cash paid on account of the price. The schedule shall be signed by an authorized representative of Borrower.

13.32.03 Final Closing – Insurance Upon Completion

See Chapter 19 for the closing details for new construction or substantial rehabilitation, Section 223(a)(7) and Section 223(f).