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## Section II Production

### Appendix 10.2 Instructions for Approval of Initial/Interim Advances

#### A. Approving Initial/Interim Advances

1. Before advancing any insured mortgage proceeds, disburse other available funding sources in the following order:
  - a. All funds from the cash escrow established by the Borrower for onsite construction, fees, carrying charges, and financing (front money escrow).
  - b. Grant/loan proceeds furnished by a national, regional, or local community service organization or a private source.
  - c. Grant/loan proceeds furnished by a government agency or instrumentality unless a pro-rata disbursement arrangement has been previously approved by the Office of Residential Care Facilities (ORCF).
2. The amount approved for a requested item cannot exceed the amount claimed by the Borrower.
3. The Lender states on the Application for Insurance of Advance of Mortgage Proceeds the cumulative total of all advances made to the Borrower, including the advance under consideration. Reconcile any discrepancies before recommending approval of the advance. Previous advances must be paid before any subsequent advances are authorized.
4. Lender-approved disbursement amounts shall not exceed the sum of the amounts approved:
  - a. For mortgage insurance;
  - b. For funding from the Borrower's cash escrow; and
  - c. For funding from available grant/loan proceeds.
5. HUD recognizes that, in order to deliver documents to the investor for satisfactory receipt and delivery of the initial GNMA Construction Loan Certificate, a de minimis first draw of the loan proceeds may need to be approved for disbursement at initial closing. The disbursements must be supported by justification and found acceptable to ORCF.

#### B. Architect's Fees

1. The Architect's cash fee is in the Standard Form of Agreement between Owner and Architect for a Federally Funded or Federally Insured Project, AIA Document B108.

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2. If there is one agreement for both design and supervisory services, a specific dollar amount must be indicated for each service.
3. There may be separate agreements for design and for supervisory services.
4. The Architect’s design cash fee may be released with the initial advance if the design is complete and ready for construction.
5. Design services provided by others as detailed in the B108AIA B108 and B108 HUD Amendment (Form HUD-92408-ORCF) must be supported by contracts approved by HUD during commitment processing before any funds may be advanced.
6. The Mortgagor’s and Architect’s Certificate (Application for Insurance of Advance of Mortgage Proceeds (Form HUD-92403-1),-ORCF) must accompany any request or partial request for advance of the design fee.
7. The Architect’s supervisory cash fee is advanced based on a percentage of completion method. The maximum amount that may be approved is computed by multiplying the Architect’s supervisory cash fee by the percentage of work completed and approved on the Contractor’s Requisition – Project Mortgages, then deducting the total of installments previously paid.
8. There is no “holdback” applied to the disbursements approved from the Architect’s Cash Fee.

C. For Insurance of Advances, the Carrying Charges, Financing, Legal, and Audit Expense must not exceed their allocations in the Building Loan Agreement. Approve items due or already paid by the Borrower ~~which~~that are supported by bills or paid receipts. Do not approve costs for interest, taxes and insurance incurred during early start period.

Note: At cost certification, certify to the actual cost without regard to release limitations imposed by the Building Loan Agreement during the Construction period.

1. Interest is to be advanced only when and as earned. The Lender must specify on Application for Insurance of Advance of Mortgage Proceeds, the period(s) for which interest is requested and the amount for each period.
  - a. At initial closing, verify as to whether a 360 or 365-day (or 366, if leap year) factor is to be used in calculating interest. Check each interest request for accuracy based on the factor indicated, and the annual interest rate approved at Initial Closing.
  - b. The Lender is prohibited from drawing down interest and refunding a portion of the money to the Borrower. Such practice constitutes a kickback and is not acceptable to HUD and will be treated as a direct mortgage reduction.

- 91 2. Taxes. In approving amounts for this line item:  
92 a. Do not allow amounts ~~which~~that accrued before Initial Closing.  
93 b. Approve invoices which are payable during construction, even if a portion of  
94 the billing period will be after an allowable cutoff date. Necessary adjustments  
95 will be made at the time of cost certification.  
96
- 97 3. Insurance. Allow amounts for fire, windstorm, extended coverage, liability, and  
98 other risk insurance customarily insured against in the community.  
99 a. Do not allow amounts ~~which~~that accrued before Initial Closing.  
100 b. Do not approve invoices/receipts for workers' compensation and/or public  
101 liability insurance ~~which~~that are included in the cost estimate.  
102
- 103 4. Mortgage Insurance Premium may not exceed the amount due for 1 year.  
104
- 105 5. Initial service charge and permanent lender fees are limited to:  
106 a. The actual amount paid, or the amount stipulated in the  
107 ~~Mortgagee's Lender's~~ Certificate (Form HUD-243492434-ORCF),  
108 whichever is less.  
109 b. The initial service fee cannot exceed 2 percent.  
110 c. The combined amount may not exceed 3.5 percent of the mortgage.  
111 d. Note: If the 3.5 percent included in processing exceeds the financing fee  
112 charges by the mortgagee, identify the excess as restricted funds.  
113
- 114 6. Legal fees may be allowed for:  
115 a. Counsel to create the Borrower entity; however, legal services for the  
116 creation of tax shelters, trusts, estate planning maneuvers, and similar efforts  
117 intended to benefit the project's principals should be excluded.  
118 b. Costs associated with counsel's review of initial and final closing  
119 documents.  
120 c. Normal interim activities in creating a project.  
121 d. Documented costs for items in paragraphs 6.a, b, and c above which are due  
122 and payable before or at final closing may be approved in the initial advance,  
123 provided the limitation in paragraph 6.e below is not exceeded.  
124 e. Seventy-five percent may be disbursed at initial closing or during  
125 construction. The remaining 25 percent may not be released before Final  
126 Closing.  
127

128 NOTE: Do not allow legal expenses connected with land acquisition, title and  
129 recording charges and/or obtaining zoning as they are reflected in the land value.  
130 Amounts included in the Maximum Insurable Loan Calculation for legal and  
131 audit expenses are not blanket allowances, but ordinarily set an upper limit on  
132 allowable amounts. Atypical fees must be borne by the Borrower, unless in an  
133 exceptionally complex case, a higher fee is proven by the Borrower to be  
134 necessary and reasonable. Detailed invoices and/or other documentation are/is  
135 required as to the reasonableness, purpose, necessity, and proper classification of  
136 all items in the category.

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7. Organizational Fees:

- a. The amount included in the replacement cost estimate for organizational fees is an allowance to reimburse the Borrower for costs incurred to:
  - i. Initiate a project;
  - ii. Organize the Borrower entity;
  - iii. Organize its planning, financing and construction, and
  - iv. ~~Control and~~ Assist the borrower to manage construction through Closing.
  - v. Third-Party costs (Appraiser etc.)
- b. Release based upon the following:
  - i. Disburse 65 percent at initial closing.
  - ii. Disburse 15 percent during construction based upon a percentage of completion.
  - iii. Disburse the remaining 20 percent at Final Closing.

Note: Lender's Third-Party Costs, reflected in Organization Costs are exempted from the 65% rule. The rule only applies to the Borrower's organizational costs.
- c. This allowance may not be used to subordinate the cash requirements for closing.
- d. At cost certification allow only the amount included in the Maximum Insurable Loan Calculation for organizational fees, unless fully supporting documentation is submitted by the Borrower ~~which~~that justifies the need for and reasonableness of the additional expenditure. Any costs incurred in excess of this allowance are not eligible for recognition in processing a mortgage increase or the equity computation on the Maximum Insurable Loan Calculation.

8. Audit fees associated with obtaining an accountant's opinion of the Borrower's cost certification cannot be advanced until Final Closing.

9. Title and Recording. Approve amounts typically incurred for:

- a. Title search and policy at the time of Initial Closing;
- b. Recording fees at Initial Closing;
- c. Mortgage and stamp taxes;
- d. Survey recording fees;
- e. Updating title policy during construction;
- f. Final title policy and recording charges; and
- g. Legal fees actually incurred and clearly for these purposes.

\*\* Do not fully disburse these funds at Initial Closing. Ensure that sufficient funds are maintained in the account to cover title and recording costs required at Final Closing. This may require the approval of an amount less than that requested in the initial draw.

\*\* Do not disburse funds for title and recording cost associated with acquisition of the land or property.

182           \*\* Legal, organizational, title, recording costs and taxes incurred in connection  
183           with the site purchase may be added to the cost of the land in establishing the  
184           latest arms' length purchase price.  
185

186           10. Developer's fee is provided in the estimated replacement cost involving non-profit  
187           Borrowers. Part or the entire fee may be used to pay for transactional costs  
188           associated with developing the project including but not limited to:

- 189           a. Reduction of the estimated closing costs of the project;
- 190           b. Staff salaries;
- 191           c. Non-profit working capital deposit;
- 192           d. Relocation expenses;
- 193           e. Operating deficit escrow;
- 194           f. Financing fees over and above the 3.5 percent included in the  
195           estimated replacement cost of the project;
- 196           g. Environment studies; and
- 197           h. Housing Consultant services provided by either in-house staff or  
198           contractor.

199  
200           11. Tap fees, soil testing and other fees. Approved disbursement must be fully  
201           supported and is not to exceed the amount estimated in the general contractor's or  
202           Borrower's list of other fees for requested items. Approve disbursement only for  
203           items actually due.  
204

205           12. The contingency reserve is included in the replacement cost of substantial  
206           rehabilitation projects.

- 207           a. Use the contingency reserve for:
  - 208           i. Unforeseen costs of necessary changes approved by ORCF.
  - 209           ii. Unanticipated soft costs associated with extension of time change  
210           orders approved by ORCF.
- 211           b. Changes classified as betterments are ineligible for funding.

212  
213           13. Third-Party Lender Expenses: Fees to be paid for third-party review costs of the  
214           Lender including but not limited to Architectural reviews, Cost reviews, appraisals,  
215           and market studies.  
216

217           14. At Initial Closing, HUD fees for examination and inspection.  
218

219           15. Sums allocated to acquisition cost of land or existing building.  
220

221           D. Allocation of Cash Available to the Borrower:  
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223           1. Allocation of cash available to the Borrower is limited to the following items and,  
224           when applicable, should be identified in an unused column on Financial Record of  
225           Mortgage Loan Transaction:

- 226           a. New Construction.

- 227 i. HUD’s estimate of the “as-is” value of land or the actual latest arms’  
228 length purchase price, whichever is less. The latest arms’ length  
229 purchase price may include the following costs incurred in connection  
230 with the site purchase:  
231 1. Legal fees associated with negotiations for acquisition of land,  
232 zoning, and examination of title on the purchase or defense of  
233 title after purchase.  
234 2. Prepaid special assessments.  
235 3. Interest on bridge loans to purchase property after the date of  
236 submission of the initial application for mortgage insurance.  
237 ~~4. Taxes.~~  
238 5.4. Cost of improvements made to the project site by the  
239 sponsor/Borrower.  
240 b. Cash escrow to cover offsite construction cost.  
241 c. Cost of any demolition reflected in the Fair Market Value of Land. Payment is  
242 approved as demolition progresses.  
243 d. Construction and/or permanent loan discounts required to be paid at initial  
244 closing.  
245 e. Escrow to cover interest shortfall escrow, working capital deposit, initial  
246 operating deposit, ~~nonrealty~~ non-realty items and any permanent loan  
247 discounts not required to be paid at initial closing.  
248 f. Remaining balance may be used to fund any approved change orders or held  
249 until Final Closing.  
250  
251 2. Rehabilitation of Existing Construction.  
252 a. HUD’s estimate of the “as-is” value by market comparison or the Borrower’s  
253 acquisition cost/existing indebtedness, whichever is less.  
254 b. Items 1a through 1f above.  
255  
256 E. Restricted Excess Mortgage Proceeds:  
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258 Restricted excess mortgage proceeds are those excess mortgage proceeds determined  
259 not to be available to the Borrower during construction, i.e., difference by which the  
260 HUD estimate exceeds contract amounts.  
261  
262 1. These funds cannot be used to satisfy any escrow requirements and must be held  
263 until Final Closing.  
264  
265 2. Identify these funds in an unused column of the Financial Record of Mortgage  
266 Loan Transaction as restricted funds.  
267  
268 F. Lender Duties for Processing the Application for Insurance of Advance of Mortgage  
269 Proceeds. The Lender must review and approve the Application for Insurance of  
270 Advance of Mortgage Proceeds conducting the following major responsibilities:  
271

- 272 1. Reconcile any discrepancies between the cumulative total for all advances,  
273 including the advance under consideration, and conclusions reached in the  
274 processing before recommending the advance for approval.  
275 a. Enter any required adjustments in Column B and note, “No Adjustment  
276 Necessary, Except Asas Indicated,” or “No Adjustment Necessary,” as  
277 appropriate.  
278 b. Enter the approved amount in the “Certificate of Mortgage Insurance” on  
279 the face of the form, and where the request is reduced; explain the  
280 disallowance on the form’s reverse side.  
281
- 282 2. Determine monthly that advances are proportionate to construction progress.  
283 a. Require the Lender’s underwriter to advise you where advances for “soft  
284 costs”, i.e., financing and carrying charges, are in excess of work progress as  
285 shown by the most current Progress Schedule accepted by the HUD and the  
286 percentage of project completion reflected on the Contractor’s Requisition –  
287 Project Mortgages.  
288 b. Take action where the mortgage is not in balance due to the fault of the  
289 contractor.  
290
- 291 3. Secure approval from HUD for any advance requesting release of any portion of  
292 the contractor’s 10 percent holdback.  
293
- 294 4. Maintain a record of approved disbursements on the Financial Record of  
295 Mortgage Loan Transaction.  
296
- 297 G. Certificate of Mortgage Insurance: (Prepare when the advance is eligible for approval.)  
298
- 299 1. The approved sum is the total for the Contractor’s Requisition and other eligible  
300 line items.  
301
- 302 2. The total approved for any item must not exceed the amount allocated to the item unless  
303 the Lender submits a written request to HUD for permission to reallocate funds  
304 between line items.  
305
- 306 3. The sum approved for mortgage insurance is the amount approved for advance less  
307 any funds remaining in the front money escrow and any grant/loan proceeds.  
308
- 309 4. For interim advances, the Lender is to prepare this Certificate and sign for HUD, to  
310 increase the amount of mortgage insurance.  
311
- 312 5. After signing the Application for Insurance of Advance of Mortgage Proceeds in  
313 the space for the Authorized HUD Official, and signing the Contractor’s Requisition  
314 – Project Mortgages (HUD-92448-ORCF) for the Director of Housing Development,  
315 the Lender sends a PDF copy of the Application for Insurance of Advance of  
316 Mortgage Proceeds, Contractor’s Requisition – Project Mortgages, Financial Record  
317 of Mortgage Loan Transaction, and supporting documentation to the HUD ORCF

318 Construction Manager.

319

320 H. ~~HUD~~ Monitoring of Interim Draws. The ~~HUD ORCF Construction Manager~~Lender will  
321 monitor interim draws. If a problem is encountered during an interim draw, ~~they~~the  
322 Lender will ~~bring~~present the problem and solution to the ~~Lender~~ORCF Construction  
323 Manager, and, if necessary, ORCF Asset Management in order to:

324

325 1. Modify the next draw, or

326

327 2. Withdraw the Lender's authority to approve advances.

328

329 I. Disbursement of Grant/Loan Proceeds. Grant/loan proceeds may come either from a  
330 governmental source, i.e., Federal, State, or local government agency or instrumentality, or a  
331 nongovernmental source, e.g., a foundation.

332

333 1. General for Governmental/Nongovernmental Source Funds. The proceeds are  
334 used to fund a front money cash escrow (Maximum Insurable Loan Calculation) at  
335 initial closing, whether the funding source is a governmental or nongovernmental entity.  
336 See paragraph 2 below for additional options to a cash escrow available to  
337 governmental source entities only.

338 a. Disbursement priority of grant/loan proceeds in relation to mortgage  
339 proceeds and other escrows is discussed in paragraph A.

340 b. Disbursement procedures from the cash escrow are discussed in paragraph  
341 D.

342 c. Release of grant/loan proceeds may not be targeted to the completion of  
343 specific onsite improvements.

344

345 2. Additional Options for Governmental Source Funds. Where the grant/loan proceeds come  
346 from a governmental source, the Borrower may use instead of a cash escrow:

347

348 a. An unconditional irrevocable letter of credit issued by a banking  
349 institution, or

350 b. An agreement entered into by HUD, the Lender, the Borrower and  
351 the governmental entity for a pro rata disbursement of the loan/grant

352