SECTION 184 INDIAN HOUSING LOAN GUARANTEE PROGRAM

Processing Guidelines 2014

Chapter 7: Single Close Construction and Rehabilitation Loans

7.1 OVERVIEW

As a result of unique logistical and market conditions which exist in Indian Country the Section 184 Program has established a single close construction and rehabilitation loan program.

Most mortgage financing plans provide only permanent financing. That is, the lender will not usually close the loan and release the mortgage proceeds unless the condition and the value of the property provide adequate loan security. When new construction is involved, this means that a lender typically requires the construction to be complete before a long-term mortgage is made.

When a borrower wants to have a new house constructed, the borrower usually has to obtain financing to construct the new dwelling, referred as an interim loan, and a permanent mortgage when the work is complete to pay off the interim loan. Often interim financing for new construction has been difficult to obtain and is a major requisite in the delivery system for new housing in rural communities.

Lenders may elect to offer separate construction and permanent loans; however, under this election, only the permanent loan would be eligible for guarantee under Section 184. In such cases, the loan is treated as an acquisition of an existing structure after construction has been completed.

The Section 184 single close construction or rehabilitation loan is a mortgage that includes all construction or rehabilitation costs, a contingency reserve, inspection/title fees and up to six mortgage payments. Only one closing is used for the Section 184 Single Close Construction or Rehabilitation loan (no interim financing required).

The single close construction loan closes prior to the start of construction or rehabilitation. The loan is eligible for a loan guarantee certificate issued by the Office of Loan Guarantee using the same endorsement requirements as all other loans; however, the program recognizes the home may not be completed at time of guarantee.

To ensure that the loan is eligible for an insurance claim to be paid (if necessary), the lender must make sure that the loan complies with the provisions below as well as the relevant provisions in the loan processing and underwriting policies found in Chapter 5 of this guidebook.

Construction Loan- The as completed value (as determined by the appraiser) must equal or exceed construction costs in order to establish a single close construction loan. At loan closing the funds required for construction are placed in a construction escrow account. Funds are advanced after the inspection is completed verifying the portion of construction completed. If there is sufficient equity, the escrow account may include funds to cover up to six monthly mortgage payments *(optional)*, to assist the borrower in paying the mortgage during the construction period. Construction should be completed within 6 months for site built homes (12 months in remote locations) or 4 months for manufactured or modular homes (12 months in remote locations).

Rehabilitation Loan- The after improved value (as determined by the appraiser) must equal or exceed rehabilitation and acquisition (if applicable) in order to establish a single close rehabilitation loan. At loan closing the funds set aside for rehabilitation are placed in a rehabilitation escrow account. Funds are advanced after the inspection is completed verifying the portion of rehabilitation completed. If there is sufficient equity, the escrow account may include funds to cover up to 4 mortgage payments, to assist the borrower in paying the mortgage during the rehabilitation period. Rehabilitation should be completed within 4 months (6 months for homes in remote locations). The costs included in the rehabilitation loan must include items required by the appraisal (after improved value). In addition, items not required by the appraisal, but are a permanent changes/addition and requested by the borrower may be included in the rehabilitation loan provided there is sufficient equity based on the after improved value.

Remote Locations. When the home is constructed in remote areas, the timelines required for single close and rehabilitation loans can be extended. For the Section 184 program, remote locations, for example, means communities that are located off existing road systems and only accessible by water or air. The appraisal should indicate if the property is located in a remote area.

Building on Own Land. An applicant is eligible for maximum financing if he/she is building a home on land that he/she already owns or acquires separately, and receives no cash form the settlement. When an applicant is building on their own land, the appropriate loan to value limits are applied to the lesser of the appraised value of the proposed home and land, or the documented cost of the land.

The documented cost of the land includes the builder's price or sum of all sub-contractor bids and materials, cost of the land (if the land has been owned more than 6 months or was received as an acceptable gift, the value of the land may be used instead of its cost), and interest and other costs associated with any construction loan obtained by the applicant to fund construction of the property.

Equity in the land (value or cost, as appropriate, minus the amount owed) may be used for the applicant's entire cash investment. However, the applicant may not receive more than minimal cash at closing ($500 or less). Replenishing the applicant's own cash expended during construction is not considered cash back provided that the applicant can substantiate with cancelled checks and paid receipts all out of pocket funds used for construction.

To determine if an applicant has made the required 2.25 percent cash investment or its equivalent in land equity when building on his/her own land, all such mortgage transactions must be summarized on the appraisal. Additionally, the calculated LTV ratio must reflect as it does on other transactions, the lesser of the sales price or appraised value or loan limit for the county/state.

Manufactured or Modular Construction- A single close construction loan may be used for new manufactured or modular housing and a rehabilitation loan may be used to improve an existing manufactured modular home (newer than a 1976). The amount of the loan is based on the as completed value for new and an after improved value for an existing manufactured or modular home. The loan proceeds can include the cost of the home, delivery, foundation, and site costs. The construction or the rehabilitation loan does not require the 10% contingency on the cost of the manufactured or modular home; however the 10% contingency applies to all foundation or site expenses.

For new manufactured or modular homes that are delivered to the land site, the lender may disburse at **closing** up to 10% of the cost of the manufactured or modular home when required by the housing dealer and approved by the borrower. This amount will not be included in the construction escrow. The HUD 1 must document the disbursement of funds to the builder.

General Eligibility Criteria:

- The home must be constructed in conformance with the Federal Manufactured Home Construction and Safety standards as evidenced by the affixed certification label. This is the RED TAG that is on the rear of each section of the manufactured home. If the RED TAG is missing the house is NOT eligible for Section 184 financing.

- Only manufactured homes built after June 15, 1976 are eligible

- The home must be classified and taxed as real estate

- The home must be permanently attached to the foundation system. The site built permanent foundation must meet or exceed applicable requirements in the permanent foundation guide for manufacture housing. A licensed builder or the manufactured home dealer must sign a warranty of substantial completion, HUD 92544.

- The finished grade elevation beneath the manufactured home or, if a basement is used, the lowest exterior grade adjacent to her perimeter enclosure, must be at or above the 100 year return frequency flood elevation.

- The axles and tongue must be removed from the unit. The chassis must stay in place.

- The house must have adequate skirting and insulation around the perimeter to prevent the crawl space area from freezing and allow proper ventilation of the crawl space. If the skirting is wood, the wood must be properly treated to prevent decay.

General Eligibility for Rehabilitation (Manufactured or Modular Housing):

- Site expenses

- The home (newer than a 1976**) cannot** be altered without an engineer certification

- The home (previous occupancy) cannot be moved to a different site.

7.2 Single Close and Rehabilitation General Requirements

The following items must be included with the loan origination file in order to qualify for a Section 184 loan guarantee as a single close construction/rehabilitation loan.

Firm Commitment Conditions- In addition to standard conditions that are required for all loans, the underwriter must require verification that the construction loan escrow account will be established and the borrower will execute the following forms at or before closing:

- 184 Applicant Acknowledgement (HUD Form 50125)
- Construction Loan Rider (HUD Form 50112)
- Construction Loan Agreement

Appraisal- The appraised value is an as completed for new construction <u>or</u> an after improved value for rehabilitation based on the plans, specifications, detailed costs of construction/rehabilitation and acquisition costs. The lender must provide the appraiser with contracts, property plans and specifications and other related construction exhibits when the appraisal is ordered. The cost approach is often the primary indication of value. The appraisal must include Marshall and Swift pages that were used to arrive at the cost approach/value.

Interest rate- The interest rate on the loan must be a fixed rate for the term of the loan. Since the loan is fully guaranteed, the rate should reflect market rates for permanent, rather than construction financing.

Timing- Loan closing must occur after the receipt of a cohort number and prior to the start of construction. Lenders who close the loan or allow construction to begin before receipt of the cohort number, run the risk that adequate funds will not be available or the completed work will not be approved for reimbursement if requested.

Construction should commence within 30 days after closing and be completed within 6 months for site built homes (12 months in remote locations) or 4 months for manufactured or modular homes (12 months in remote locations).

Rehabilitation should commence within 30 days after closing and be completed within 4 months (6 months for homes in remote locations).

If the work is not completed within the allotted timeline, the borrower and builder must request an extension of time on HUD form 92577 and provide adequate justification for the extension. Extensions will not impact the term of the mortgage. The loan amount or loan term cannot be increased to cover any cost over-runs or construction delays.

Hazard Insurance- The prepaid hazard insurance must be calculated based on the completed property.

Property Taxes- The prepaid property taxes should be calculated based on the completed property (land and dwelling) to ensure that the escrow funds are sufficient. Property taxes are not applicable when constructing on tribal or allotted trust lands.

HUD Form 50132--184 Maximum Mortgage Worksheet: In order to determine the maximum mortgage amount on single close and rehabilitation loan, lenders are required to use HUD Form 50132 (184 Maximum Mortgage Worksheet for Rehabilitation and Single Close Construction Loans). The amounts totaled on this worksheet will be used to complete the final MCAW for maximum loan calculation.

Homeowner/Contractor Agreement- The agreement is between the borrower and the contractor and specifies the terms of the construction contract and incorporating the architectural exhibits into the contract. At a minimum, the agreement should (1) describe the work to be performed; (2) state when work will start and finish; (3) state the total amount to be paid to the contractor and terms of payment; (4) provide provision for binding arbitration on any disputes; and (5) provide a one year warranty on all work completed by the contractor. If the lender has determined the borrower has sufficient experience to do the work or act as the general contractor, the lender should obtain a self-help agreement from the borrower.

Plans and Specifications- Lenders should obtain plans and specifications for the construction or the rehabilitation work. The plans and specifications (used to arrive at an after improved value) are provided to the appraiser and must be included in the loan binder.

Construction Cost Estimate- Loan applications should include a detailed cost breakdown for all construction. The estimates used must include labor and materials sufficient to complete the work. All work must be done by a state (when applicable) licensed contractor or tribal approved contractor. All costs to construct/bids must be signed by both the contractor and borrower.

Construction Loan Agreement - Construction customarily should commence within 30 days after loan closing. The construction loan agreement that references the projected commencement date for construction must be executed at loan closing and included with the endorsement/guarantee package.

Schedule of Amounts for Contract Payments- This form details the construction loan breakdown by the contractor in sufficient detail to guide construction drawdowns. It is important that the lender analyze the breakdown in order to avoid "front loading" of draws. (In some instances, lender may request supporting bids from subcontractors and suppliers.)

Construction Progress Schedule- Contractor's planned construction schedule to cover the period of time from the starting date stipulated in the contract through the date of actual contract completion. The schedule may be computer or manually generated as long as the information is realistic and accurate in a format providing acceptable data. The lender may compare the schedule with periodic compliance inspection reports to monitor progress. If the lender finds, as the work progresses, that there is or has been a slowdown of construction, he/she shall discuss the matter with the borrower and request that the borrower request the contractor to correct the undesirable condition and, if possible, to recover the lost time.

Architectural Exhibits-

- **Plot Plan of the Site-** Shows the location of the structure with setbacks, driveways, water/sewer lines, flood elevation, and other relevant details.
- **Plans and Specifications-** Shows elevations, floor plan and sufficient details of materials to direct the work. All work must be in accordance with local building codes, as applicable.
- **Cost estimate.** This estimate must be the best estimate of the cost to complete the project. Cost estimates must include labor and materials sufficient to complete the work by the contractor.
- **Site map and legal description of the property.**
- Name addresses and phone number of the builder.
- Builder certification HUD 92541

Construction Escrow Account- The construction/rehabilitation escrow funds must be deposited in an insured interest bearing account in the name of the borrower. The borrower will identify how the interest will be paid (to borrower after completion of the construction or applied to the unpaid principal balance).

Infrastructure- All new construction must be reviewed to ensure sufficient water and sewer systems exist. If new systems are being installed the file must evidence all costs and for installation and identify sources of funds (i.e., Indian Health Services).

Off-site infrastructure- New construction project development. If a tribe or IHA incurs specific costs to develop the offsite infrastructure of a project development, Section 184 will allow the lesser of: the actual pro rata portion of those cost to be included in the cost of the individual or (b) up to15% of the cost to construct the subject house. Any costs included will be limited by the appraised value and loan limits for the area.

7.3 Construction/Rehabilitation Builder Requirements

The Office of Loan Guarantee permits the borrower to select their own builder (or housing dealer) for all single close construction or rehabilitation loans. All builders (including an owner builder) participating in this Section 184 loan program must be either state licensed or approved by the local tribe. The loan binder must contain sufficient information to document the qualifications of the builder. Documentation of builder qualifications should include:

Copy of a current state/tribal license or tribal approval

1. Evidence that the company is in good standing will all trade references as documented by a credit report on the building company.
2. Have evidence of current working capital and/or credit line sufficient to cover 150% of the largest anticipated scheduled draw amount.
3. Trade references with contact information
4. Documented experience in similar sized projects
5. Bank references including lines of credit

7.4 Costs Eligible for Inclusion in Mortgage

Lender Fees- In order to cover the costs of administering the construction or rehabilitation process, lenders are permitted to charge borrowers a construction administration fee not to exceed 1.5% of the base loan amount (fee is in addition to the standard closing costs and prepaid escrows). The lender cannot charge a construction administration fee on non-construction costs (i.e., cost of land, payoff of existing structure, etc.).

Inspection Fees- For each draw request, the lender is required to obtain the inspector's signature stating that the work for that draw has been satisfactorily completed.

- Inspection fees should be included in the construction/rehabilitation interest bearing escrow account.
- Inspection fees must be reasonable and customary for the area.
- Any unused inspection fees (escrowed) will be used to pay down the principal or they can be used for additional permanent property improvements.
- If the required inspection fees exceed the amount escrowed, the borrower will be responsible for payment outside the escrow account.
- An inspector may charge for mileage. The fee for mileage should be reasonable and customary for assignments that require 50 or more round trip miles from the inspector's place of business to the subject property.
- All construction inspections must be performed by an FHA approved inspector, a state/local licensed and/or a qualified inspector who is approved by the lender. The inspector must be a disinterested third party and cannot be personally or financially related to the builder, borrower, or other interested party. Indian Housing Authority (IHA)/Tribally Designated Housing Entity (TDHE) staff may do the inspections if they are qualified and acceptable to the lender. IHA/TDHE inspectors may not charge the cost/time for Section 184 inspections to other HUD housing programs.
- Inspector fees may not exceed the number of draw requests. Payment of fees will be included with the draw request.

Title Update Fees on Fee Simple Land- In order to ensure that the mortgage position remains intact on the title, a lien waiver or title update is required upon completion of the new construction or rehabilitation. These costs must be shown on the Good Faith Estimate and included in the construction escrow account. Title update fees cannot exceed what is reasonable and customary for the area. Any unused title fees (escrowed) will be used to pay down the principal once the construction or rehabilitation is complete.

Title Update Fees on Trust Land- For trust or individual allotted land, the lender is **not** required to obtain an updated Title Status Report.

Land Purchase- The cost of land (if applicable) may be included in the mortgage provided the after improved appraised value equals or exceeds the cost of construction, land purchase, and other applicable/allowable fees. The lender must obtain a copy of the land sales contract. The value of the land must be included in the appraisal. The amount owed for the land will be paid at closing and not included in the construction escrow account.

Mortgage Payments during Construction- An allowance for up to 6 mortgage payments for new construction and up to 4 months for rehabilitation can be included in the construction escrow account to enable the borrower to make payments during the construction period.

- The mortgage must begin amortization with the first monthly payment, whether or not construction of the property has started.
- Mortgage payments may be withdrawn by the lender on a monthly basis.
- If the construction period extends beyond the allotted timeline, the borrower must begin to make mortgage payments from non-escrow funds.

Contingency Reserve

The contingency reserve fund is for cost overruns or unforeseen circumstances during the construction/rehabilitation period. A 10% contingency reserve is required for rehabilitation/construction loans greater than $10,000. The required 10% contingency reserve is based on all site built homes, rehabilitation to an existing home, and site improvements, which include infrastructure, foundation, installation, utility hook-ups, and finish items to the dwelling. If the lender believes that a contingency reserve of more than 10% is needed, the lender may require the borrower to increase the amount; however, the maximum allowable is 20%.

The 10% contingency is **not** required for manufacture or modular homes that are built off site and delivered to the property.

When a cost overrun or unforeseen circumstance occurs, the borrower/builder will notify the lender and submit documentation to the lender requesting use of funds and amount required. The lender will review and approve prior to the work being done. If the lender approves of the costs then they must document this by filling out a change order request form (HUD-92577). Approval and use of contingency reserve funds must be documented in the loan binder upon submitting the final construction close out file to the Office of Loan Guarantee.

Unused Contingency Funds- Upon final completion of the planned construction/rehabilitation when there is no additional money needed for improvements the remaining contingency funds in the contingency reserve account may be disbursed.

If the contingency funds were included in the mortgage amount, then the unused balance in the account may be used for additional home improvements with prior approval from the lender or applied to unpaid principal balance of the loan.

If the contingency funds were not funded in the mortgage, but paid by a gift donor or the borrower, the funds may be returned back to the borrower, applied to the principal balance of the mortgage, applied to permanent home improvements (with approval from the lender), or returned back to the gift donor. Funds must be returned to the gift donor if that was a condition of receiving the gift funds.

Additional Improvements- The borrower may request the use of the contingency funds to make permanent changes or improvements to the home when the project is at least 95% complete. Underwriter will review request and if approved execute the change order request (HUD-92577). However, underwriters should ensure sufficient funds are retained in escrow (an amount equal to 1-1/2 times that estimated) for any uncompleted work before authorizing depletion of the contingency reserve.

Shortage of Contingency Funds- OLG must be notified when cost overruns or unforeseen circumstances exceed the contingency reserve balance. The shortage must be paid by the borrower outside the mortgage agreement at the time the costs are incurred. The lender is responsible for ensuring these funds are paid by the borrower.

Reimbursement for Stored Materials and Shipping Costs.

In remote areas, the lender may reimburse payments for building materials or components to be shipped and stored on site provided written verification is received that:

- Prior to shipment the material is stored and protected from weather in a bonded-storage yard or other suitable place as may be approved by the lender.
- The material is insured to cover its full value as verified by purchase invoices.
- The materials are referenced in the itemized cost estimates section of the Construction contract and will be used exclusively for the approved contract.

7.5 Schedule of Payments to Builders

Progress Payments for Modular Homes in Remote Locations- If a lender wishes to, and the choice is completely at their discretion, the following payment schedule may be authorized for modular home construction located in remote locations (as defined above):

1 Ten Percent (10%) of the loan guarantee amount upon the closing of the loan;

2 Forty Percent (40%) payment of the loan guarantee amount when the constructed home(s) is securely placed on method of delivery for shipment. However, payment will not be made until the underwriter has reviewed the construction inspection reports from the factory as well as the certificate of insurance naming the lender, borrower and HUD as loss payees. The policy should provide full coverage for loss or damage for the home(s) F.O.B. to the project site;

3 Thirty Percent (30%) payment of the loan guarantee amount when the home(s) is delivered to the project site, affixed to a traditional foundation, and inspected.

4 Twenty Percent (20%) payment of the loan guarantee amount when final inspection is complete and a certificate of occupancy or equivalent (as determined by HUD) has been issued.

In order to qualify for this advanced payment schedule, and in order to reduce the excessive layering of risk, the lender will need to verify that the borrower meets at least two of the five factors listed below:

- Minimal housing increase (no more than 25 percent)
- Strong credit history (credit score of 700 or greater)
- The applicant has a debt-to-income qualifying ratio below 41 percent
- The applicant has substantial cash reserves after closing (three months or greater)
- Loan-to-Value ratio is 90 percent or less

If the borrower does not meet at least two of the five factors listed above then progress payments cannot be made on the advanced schedule listed above.

7.6 Rehabilitation Loans

There are two types of rehabilitation loans:
- Rehabilitation with no cost of acquisition (borrower owns the property)
  Acquisition (home or land) and Rehabilitation

The appraiser will arrive at a value by reviewing the existing property with the proposed rehabilitation and arrive at an after improved value.

Eligible Improvements- A minimum of $10,000 in repairs is required in order to include rehabilitation in the financing of a Section 184 loan. By themselves minor or cosmetic repairs or appliances that are not a condition in the appraisal are not eligible expenses; however, may be included after the initial $10,000 requirement is met. The rehabilitation must include one or more of the items listed below, with a cumulative total of $10,000 or more.

- Structural alterations and reconstruction
- Changes for improved functionality and modernization
- Elimination of health and safety hazards (including the resolution of defective paint surfaces and/or lead based paint problems on homes built prior to 1978)
- Changes for aesthetic appeal and elimination of obsolescence
- Reconditioning or replacement of plumbing (including connecting to public water and/or sewer system), heating, air conditioning and electrical systems
- Roofing, gutters and downspouts
- Flooring, tiling and carpeting
- Energy conservation improvements (i.e., new double pane windows, insulation, solar domestic hot water systems, etc.)

- Site improvement, patios and terraces that improve the value of the property equal to the dollar amount spent on the improvements or required to preserve the property from erosion
- Improvements for accessibility to the handicapped

Swimming Pools- The cost to repair an existing swimming pool is acceptable provided the cost is not included in the initial $10,000.00 threshold to qualify for a rehabilitation loan. A rehabilitation loan cannot be approved to install a new swimming pool.

Unacceptable Rehabilitation/Repair Items- Luxury items and improvements that do not become a permanent part of the real property are not eligible.

7.7 Post Closing Requirements

Within 30 days of completion of the construction or rehabilitation, the lender must submit the items listed on the Post Endorsement Submission Checklist (HUD Form 50119). As part of this process the lender needs to make sure to include the termite report, builders certification, a one year warranty, a flood certificate, a final health inspection for well and septic, and at least one of the following: a 10 year warranty, a minimum of 3 inspections by a fee inspector, or a building permit and certificate of occupancy (or their equivalent). The purpose of this documentation is to verify completion of the home and close out the construction/rehabilitation file.

7.8 Escrow Holdback

If repairs or improvements are addressed on the sales contract or appraised value cannot be completed before loan closing, the lender must establish an escrow holdback, using Mortgagee's Assurance of Completion form (HUD Form 50118) to ensure eventual completion of all required repairs. At closing, the lender must collect an amount equal to 1.5 times the cost of the repair improvement as established by the bid(s) from the contractor.

The work should be completed within 30 days after closing (90 days for remote areas). The lender must obtain a final inspection and provide evidence the funds were disbursed for the work performed and any unused proceeds were paid to the funder, applied to the unpaid principal balance or used for additional permanent improvements.

7.9 Foreclosure of Construction/Rehabilitation Loans

The loan guarantee is effective as of the date of its issuance by HUD. If a borrower defaults on a loan after a guarantee has been issued but before construction/rehabilitation is complete, then the lender must immediately begin to comply with the Section 184 processing guidelines dealing with loan servicing (as outlined in PIH-2014-11). The best way to ensure a good resolution to a borrower's default is by immediately contacting the Office of Loan Guarantee to try to come up with appropriate remedies.

Escrow Account Frozen- When a loan has gone into default, the lender must immediately freeze all funds held in the Single Close Escrow Account and the Contingency Escrow Account, if funds are held separately. No further disbursements can be made from these accounts without the permission of the Office of Loan Guarantee.

Final Inspection- In the event of a default during the construction period lenders must request a final inspection to compensate the contractor for all work completed through the date of assignment. In addition the lender must assign an inspector to review the property**.** The inspector will use the Compliance Inspection Report and a draw request to document the amount of work that has been completed since the start of construction. The inspector will itemize the work necessary to complete construction and the estimated cost. OLG will determine the value of the completed work and authorize the release of escrowed funds.

Using a similar format to the final release, OLG will then authorize release of payment for completed work, as well as the release of holdbacks on advances previously released. The lender is to submit a copy of the final release notice with the claim for loan guarantee benefits. If funds remain in the construction escrow account, the amount of the claim (the unpaid principal balance) must be reduced by the unexpended funds remaining in the account.

Final disbursements of proceeds in the remaining construction escrow and construction contingency escrow account, if held separately, are to be disbursed in priority order as follows: the account balance plus all accrued interest to date will be disbursed as a principle reduction payment to reduce the mortgage balance.

The insurance claim package must include evidence of all disbursements made to date and a final accounting for all account balances held by the lender. No claims will be honored without the accompanying account balance data.