

Section II Production

Chapter 18 Insurance Upon Completion

18.1

Introduction

Insurance Upon Completion (IUC) is an option available to Section 232 New Construction, Substantial Rehabilitation and Section 241(a) projects where HUD insures only the permanent loan. This differs from Insured Advances (IA) projects where HUD insures both the construction and permanent loans. There is no closing prior to start of construction as there is on IA projects. Instead, there is one closing following construction completion and cost certification. On IUC projects, construction must not start until after the issuance of a Firm Commitment. As with IA projects, ORCF completes a full underwriting review of IUC projects prior to issuance of a Firm Commitment. IUC and IA projects follow the same process and requirements: Firm Application, Firm Commitment, Pre-Construction Conference, Construction, Cost Certification, and Closing. Specific information pertaining to IUC within each stage is outlined below.

18.2

Firm Application

When the firm application is submitted, the Lender must notify ORCF of their intent to use IUC. Lenders may utilize either the Direct-to-Firm or the Two-Stage application process for IUC projects. See Production, Chapter 1 for information on the Direct-to-Firm and Two-Stage application processes.

Construction must not start until issuance of a Firm Commitment and completion of the Pre-Construction Conference.

Items that need to be addressed for IUC projects prior to issuance of a Firm Commitment and completion of the Pre-Construction Conference include:

A. Prior to issuance of a Firm Commitment, HUD will complete the following reviews:

1. Firm Application Underwriting Review,
2. Appraisal Review,
3. Part 1 Legal Review,
4. Title/Survey review, and

5. Environmental Review.

- B. **Working Capital.** Projects must meet Working Capital escrow requirements except for the extra 2% construction contingency portion of the working capital requirement. This escrow must be established prior to closing, and must be accounted for in the Firm Application submission (see Production, Chapter 2).
- C. **Initial Operating Deficit Escrow (IOD).** The Lender must prepare an Initial Operating Deficit analysis as part of the firm application. The IOD is to be funded at closing, and can only be used to cover post-closing losses. Prior to closing, ORCF may require the IOD to be increased based on actual performance at the project.
- D. **Minor Movable Escrow.** A Minor Movable escrow is not required. Prior to closing all Minor Movables must be in place.
- E. **Bond Premium/Assurance of Completion.** Not required.
- F. **Latent Defects Escrow.** A latent defect escrow of 2.5% of the construction costs is required. This must be in the form of a bond, escrow or letter of credit. The cost of the bond or letter of credit may be included in the Contractor's Fees if reviewed and deemed reasonable by the third party architectural and cost analyst.
- G. **Off-Site and Demolition.** Off-site and Demolition escrows are not required for IUC projects, however, in the firm application the Lender must explain the work to be completed and the costs associated with that work. The cost of this work is not eligible at cost certification.
- H. **General Contractor Underwriting Review.** ORCF will look to the Lender and Third Party Architectural and Cost reviewer to ensure that the general contractor meets HUD requirements. If the General Contractor does not meet all of ORCF's requirements, or is unable to certify to everything in the Consolidated Certification – Contractors (Form HUD-90018-ORCF), the developer and Lender must acknowledge that they are willing to accept this risk during the course of construction. Experience of the General Contractor remains a serious consideration for IUC projects. ORCF will review the following:
 - 1. Previous Participation Certification. See Housing Notice H 2016-15 (or successors thereto) for additional information on the previous participation certification and review process.
 - 2. Financial Capacity to assure that there is sufficient capacity to cover the latent defects escrow.
 - 3. General Contractor's experience and ability to complete the project.

- I. **Builder's Risk.** ORCF does not require Builder's Risk Insurance. Should the Borrower choose to include Builder's Risk Insurance, it must be listed as either a Borrower's Other Fee or a Contractor's Other Fee in the firm application.
- J. **Interest during Construction.** ORCF will allow for a reasonable amount of Interest during Construction to be included in the HUD Replacement Cost calculation on the Form HUD-92264a-ORCF. The approved amount will be included in the firm commitment. Any increase requires HUD approval.
- K. **Mortgage Insurance Premium (MIP).** No MIP is paid during construction. An excel spreadsheet for calculating MIP is embedded in the Lender Narrative Cost Certification Supplement (see the Section 232 Program website). This must be reflected in the Lender's Maximum Insurable Loan Calculation (Form HUD-92264A-ORCF) ("MILC").

18.3

Firm Commitment

ORCF will issue the firm commitment on the Commitment to Insure Upon Completion following Loan Committee approval. For IUC projects, this firm commitment will include, but not be limited to:

- A. The firm commitment must be valid and outstanding until closing on the permanent mortgage.
- B. **Expiration Date.** The firm commitment's expiration date should provide for sufficient time to complete construction, cost certification and drafting and review of the closing documents. Typically, this is 1.5 times the construction period, but the Lender should recommend an expiration date based on the complexity of the project.
- C. **Extensions.** See Production, Chapter 9 for the extension of Construction period and Firm Commitment expiration date, if required to permit project completion and Final Closing. ORCF may re-evaluate the market and/or other elements of the project prior to granting extension requests.
- D. **Amendments.** Should the Firm Commitment require any amendments or changes after issuance see Production, Chapter 9.2.

18.4

Pre-construction Conference

For IUC projects:

- A. The Pre-construction Conference must precede the initial start of construction. See Production, Chapter 10.3 for Pre-Construction Conference requirements. The ORCF Closer

should attend the Pre-construction Conference as they will be involved from this point until Final Closing.

B. The following are to be submitted by the Lender and reviewed by the ORCF Underwriter and the HUD Closing Attorney prior to the Pre-construction Conference:

1. Building Permits.
2. Construction Contract (Form HUD-92442-ORCF). The following must be made part of the contract:
 - a. General Conditions, AIA Document A201;
 - b. Supplementary Conditions of the Contract for Construction (Form HUD-92554-ORCF); and
 - c. Davis-Bacon Wage Rates (supplied by HUD Office of Labor Standards and Enforcement (OLSE)).
3. Contractor's Prevailing Wage Certificate portion of the Contractor's Requisition Project Mortgages (Form HUD-92448).
4. Certification regarding Architect's E&O Insurance (with Certificate of Insurance attached) for design and supervisory architects.
5. Construction Progress Schedule.
6. Agreement and Certification (Form HUD-93305-ORCF). This document must be executed by the Borrower, Lender and ORCF prior to the Pre-construction conference.
7. Inspection Fee.

C. If the project is currently occupied:

1. A Management Conference with the assigned Account Executive and Lender should occur prior to the Pre-construction Conference.
2. From start of construction through Final Closing, the Borrower and/or Operator must provide ORCF and Lender with ongoing operating statements as requested, and must notify the AE of State Surveys that occur at the project.

D. If the project is new construction and/or is not currently occupied, a Management Conference with the assigned AE should occur prior to occupancy.

During Construction, for IUC:

- A. **Construction monitoring.** Reporting must be done in accordance with Production, Chapter 10.4.
- B. **Labor and FHEO liaison.** See Production, Chapter 10.13.
- C. **Contractor's monthly requisitions.** Not applicable to IUC projects.
- D. **Offsite construction.**
 - 1. Monitoring is recorded by the HUD inspector on the HUD Representative's Trip Report (Form HUD-95379-ORCF).
 - 2. Advance of funds monitoring is not applicable to projects insured upon completion.
- E. **Construction contract changes and Architect's supplemental instructions (see Production, Chapter 10.9 – 10.12 and Chapter 10.5.D).** Construction changes are processed in the same manner as insurance of advances, except as modified below:
 - 1. An escrow is not required for additive change orders, because HUD has no risk exposure until closing. The Borrower must be able to provide the additional funds required and must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented for insurance.
 - 2. Surety approval is not required for the approval of additive change orders regardless of the percentage of contract increase.
- F. **Seventy percent (70%) Construction Completion.** When onsite construction is 70% complete (before closing of the credit instruments), the Lender must prepare a property insurance schedule and requirements. Evidence must be provided that the facility has all required Fidelity, Property, and Professional Liability Insurance coverages. The insurance coverages must be current and in conformance with all ORCF requirements. If the policy is about to expire within one month of closing, provide proof of renewal. See Production, Chapter 14 for details on insurance coverage and requirements.
- G. **Permission to Occupy.** Applies as in Production, Chapter 10.7.A.
- H. **Final HUD Representative's Trip Report.** Applies as in Production, Chapter 10.7.B.
- I. **Warranty Inspections.** Nine- and Twelve-month warranty inspections apply as in Production, Chapter 10.7.C.

18.6

Cost Certification

Cost certification is required for all insured Section 232 and 241(a) applications except as noted in Production, Chapter 11.4. The purpose for certification is to establish the Borrower's actual costs, including contractor's cost, to establish the "Maximum Insurable Mortgage" (MIM) for closing of the FHA-insured mortgage. A MIM letter will be issued upon conclusion of the cost certification package review. For more information on the cost certification process, please see Production, Chapter 11.

Specifically, the cost certification is required to be submitted in advance of closing. This is to ensure the MIM amount is determined and finalized before closing documents are prepared. For specific information on:

- A. Entities that must cost certify (see Production, Chapter 11.6),
- B. Required Forms and Documentation (see Production, Chapter 11.10),
- C. Required Cost Certifications (see Production, Chapter 11.11), and
- D. Allowable Costs in Borrower's Certificate of Actual Cost (see Production, Chapter 11.13).

18.7

Closing

Once construction has been completed and certification of costs has been presented to and approved by ORCF, the Borrower must proceed to closing. ORCF will issue a MIM Letter, upon completion of the cost certification review, providing the final mortgage determination. Once the letter is issued, immediate preparation for closing should begin. Closing documents are to be submitted within 30 days of the date of the MIM Letter.

- A. Requirements for Closing for IUC projects are set out in the IUC Closing Checklist (see the Section 232 Program website) and the MIM letter. Required documents include, but are not limited to, the following:
 - 1. **Proof of Completion.** For the purpose of closing the mortgage transaction, completion means that the project has been completed in accordance with the drawings and specifications, except for approved items of delayed completions covered by an acceptable Escrow Agreement, and the entire project has been accepted for occupancy by local authorities, by the Lender, and by ORCF.
 - 2. **Labor Standards and Enforcement Clearance.** The Office of Labor Standards and Enforcement (OLSE) must confirm that all Davis Bacon violations have been cleared. If there are outstanding violations, the OLSE Specialist will inform the Lender and ORCF Closer that deposits to the U.S Treasury must be established as a condition of closing to ensure payment of wages. HUD's OLSE must provide approval to proceed to Final Closing (see Production, Chapter 4, Appendix 4.1 HUD Labor Standards and Enforcement Protocol).

3. **Public Approvals.** If issues have arisen regarding the zoning of a project, the HUD Closing Attorney may require submission of additional evidence to verify compliance with local zoning laws and/or building codes.
4. **Construction Contract.** The following must be part of the Contract:
 - a. General Conditions, AIA Documents A201,
 - b. Supplementary Conditions of the Contract for Construction,
 - c. Davis Bacon-Wage Rates (supplied by HUD Labor Relations);
 - d. HUD Amendment to the B108,
 - e. Cost Certification criteria from Construction Contract (Form HUD-92442-ORCF), Article 4, where an identity of interest exists, or a “cost plus” form of contract is used.
5. **As-Built Drawings and Specifications.** A complete “As-Built” set of drawings and specifications, incorporating change order to date, and one electronic “Master Set” on CD.
6. **Agreement and Certification, (Form HUD-93305-ORCF).** This document must be executed by the Borrower, Lender, and ORCF prior to the Pre-construction Conference.
7. **Title Policy.** Title Policy or title evidence must be dated the day of closing and show:
 - a. Insured property free of all encumbrances except those found acceptable by HUD;
 - b. Proof that no unpaid obligations exist except as previously approved by ORCF.
8. **As-Built Survey.** Current ALTA/ACSM surveys are required for all closings. The final As-Built survey, or its most recent update, must be dated with 120 days of the closing. The term “dated” means the surveyor’s certification must show that the survey was made “on the ground” within 120 days prior to closing. The survey must show the exact location of all building, water, sewer, gas and electric mains, and all easements for such existing utilities. The survey must be prepared, signed and sealed by a licensed surveyor and must include a certification in the format set out in Survey Instructions and Borrower’s Certification (Form HUD-91111-ORCF).
9. **Contractor’s Prevailing Wage Certificate.** The Contractor’s Prevailing Wage Certificate portion of the Contractor’s Requisition Project Mortgages (Form HUD-92448) must be submitted at the time the mortgage is presented to ORCF for insurance.
10. **Operating Deficit.** If an operating deficit was required in the Firm Commitment, the Borrower must provide funds to meet the deficit at closing. The Firm Commitment

requirements concerning funding are not waived, in whole or in part, unless specifically approved by ORCF. Amendments or modifications between the start of construction and closing will not be waived without prior written approval of ORCF. Assurance of funds to meet an operating deficit is required as noted above, in Section 18.2.C. The following completed forms may be required to assure funds are available to carry the project to a sustaining occupancy after closing:

- a. Escrow Agreement Additional Contribution by Sponsors (Form HUD-92476-A),
- b. Escrow Agreement (Form HUD-92476.1),
- c. Bond Guaranteeing Sponsors' Performance (Form FHA-2477), and
- d. IOD Analysis based on current lease-up performance.

11. **Builder's Warranty against latent defects.** At closing, the general contractor must address latent defects by:

- a. Entering into the latent defects agreement with HUD (Form HUD-92414-ORCF (REV 03/13), and either:
- b. Funding a cash escrow deposit equal to 2.5% of the construction contract, or
- c. Providing an irrevocable, unconditional letter of credit issued to Lender by a banking institution, or entering into the Latent Defects Escrow (Form HUD-92414-ORCF), which requires a latent defects escrow of 2.5% of the total amount of the Construction Contract, in the form of a surety bond, cash escrow or letter of credit.

12. **Final Draw.** Unlike Insured Advances projects, IUC projects will only have one draw. In the IUC Closing Package, the Borrower will provide the Requisition For Disbursement of Funds (Form HUD-92403-CA). This form shall be consistent with the approved Maximum Insurable Mortgage amount listed in the MIM Letter and the Closing Statement.

13. **Amortization.** Amortization starts the first day of the second month following the date of Final Closing.

14. **After Final Closing.** Following final closing, the Closer will ensure all post-closing documents are received. The Closer will notify the assigned AE that the project has completed Final Closing.