

CHAPTER 11. BASIC INSTRUCTION - COST CERTIFICATION

11-1. INTRODUCTION. Cost certification is required by Section 227 of the National Housing Act and HUD Regulations for all multifamily projects except for Sales Type projects under Section 213.

11-2. NOTIFICATION OF PRE-COST CERTIFICATION CONFERENCE. Notify the mortgagor, mortgagee, and general contractor, if applicable, by letter of the pre-cost certification conference requirement when the project is 80 percent complete.

A. The conference should be attended by the mortgagor, general contractor, their accountants and the mortgagee.

B. Send with the letter:

1. Handbook 4470.2, Cost Certification Guide for Mortgagors and Contractors of HUD-Insured Multifamily Projects.

2. Handbook IG 2000.4, Consolidated Audit Guide for HUD Programs.

3. Four copies of each of the applicable forms:

a. Form HUD-92330, Mortgagor's Certificate of Actual Cost.

b. Form HUD-92330A, Contractor's Certificate of Actual Cost, if applicable.

C. File copies of the letter in the Washington Docket, Office Docket, and Mortgage Credit File.

NOTE: Encourage new sponsors and general contractors to contact the Field Office earlier than the 80 percent completion mark if their accountant has never prepared a cost certification.

D. In preparation for the conference, ask the Wage and Hour Compliance Specialist in the Labor Division to check for completeness of required wage certifications. Discuss the results of this review and any other labor related problems at the conference.

11-3. JOINT PRE-COST CERTIFICATION CONFERENCE. The Cost and Mortgage Credit staffs should hold a joint pre-cost certification conference with the parties identified in paragraph 11-2.A before the project is 90 percent complete. At the conference, explain:

A. Final completion, administrative completion and cut-off dates.

B. Documentation required, including the income statement and balance sheet.

C. Importance of a careful review of the documentation before submitting the cost certification to HUD.

D. Necessity for completeness of the documentation, including dates and signatures, and timeliness of the submission.

11-4. FINAL COMPLETION DATE FOR DETERMINING ACTUAL COSTS is the date the HUD representative signs the Trip Report, Form HUD-5379, showing construction is complete subject to acceptable items of delayed completion and the Chief of A, E & C endorses the report as representing final inspection.

A. Field Office Manager notifies the mortgagor, general contractor and mortgagee in writing of the final completion date for the determination of actual cost. The letter states that:

1. The final completion date is the effective date for cost certification except that the cost of interest, taxes, insurance, mortgage insurance premiums and finance fees incurred up to 60 days beyond this date may be included at the option of the mortgagor.

a. The purpose of the additional 60 days is to allow for rent-up of the project.

b. The date selected by the mortgagor is known as the cut-off date.

2. The date of the balance sheet and operating statement must coincide with the cut-off date selected by the mortgagor.

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(11-4) 3. The cost certification should be submitted within 30 to 45 days of cost certification cut-off date, but no later than at least 30 days before the desired final closing date.

B. Copies of the notification letter go to the Washington Docket, Office Docket, Mortgage Credit file and Closing Attorney's file.

11-5. ADMINISTRATIVE COMPLETION DATE. The Field Office Manager may advance the completion date to prevent unnecessary accumulation of soft costs. This is done when projects nearly completed face unnecessary delay.

A. The Manager may set an administrative completion date for any project when the monthly inspection reports show 95 percent completion of work and thereafter less than 2 percent increase in percentage of completion in any month.

B. The Manager notifies the mortgagor, general contractor and mortgagee in writing of the administrative completion date and the following:

1. The administrative completion date is the effective date for cost certification except that the cost of interest, taxes, insurance and mortgage insurance premiums and financing fees incurred up to 60 days beyond this date may be included at the option of the mortgagor.

2. The date of the balance sheet and operating statement must be the same as the cut-off date selected by the mortgagor.

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 final completion.

4. The cost certification should be submitted within 30 to 45 days after cost certification cut-off date, but no later than at least 30 days before the desired final closing date.

C. Copies of the notification go to the Washington Docket, Office Docket, Mortgage Credit file and Closing Attorney's file.

11-6. REQUIRED STATEMENTS AND CERTIFICATIONS. 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) and FHA-2580, Maximum Insurable Mortgage. An accountant's opinion is not needed.

1. Simplified cost certification is permitted for:

a. Section 220(h), improvement loans of \$200,000 or less.

b. Projects involving 40 units or less (exclusive of Section 207 projects).

c. Condominium projects (Section 234), if the project mortgage is to be terminated at completion or final closing and conversion to individual unit ownership. Otherwise, you must follow long form cost certification procedures in paragraph 11-6.B.

d. Section 202 Direct Loan projects funded under 24 CFR Part 885 Subpart B with loans of \$500,000 or less.

e. Section 202 Direct Loan projects funded under 24 CFR Part 885 Subpart C with loans of \$750,000 or less.

f. Section 202 or 811 capital advance projects funded under 24 CFR Part 889 or 890, respectively, with mortgages of \$750,000 or less.

2. If there is an identity of interest between a subcontractor, supplier, equipment lessor or manufacturer of industrialized housing and the mortgagor and/or general contractor who must cost certify and the total of all identity of interest subcontracts, purchases and leases is more than 1/2 of 1 percent of the mortgage, Form HUD-92330 must be accompanied by an unaudited Form HUD-92330A from the identity subcontractor, supplier, equipment lessor and/or manufacturer of industrialized housing. This requirement applies regardless of:

a. The form of construction contract used.

(11-6) b. Whether the general contractor is required to cost certify, if the identify of interest is with the mortgagor.

3. An unaudited balance sheet of the mortgagor entity, as of the cut-off date is required in all cases. If total construction cost does not agree with HUD records of disbursed and undisbursed mortgage proceeds, reconciling information must be submitted.

a. Format and content of the balance sheet must follow paragraph 11-6.B.2.

b. The balance sheet must contain the certification of truth and accuracy, signed and dated by an officer of the mortgagor entity and the criminal certification which appear on the back of Form HUD-92417. The certifications must reference the name of the mortgagor entity and the date of the statement.

4. An unaudited operating statement is needed if occupancy occurred during construction.

a. Format and content of the operating statement must follow paragraph 11-6-B-3.

b. The statement must contain the certification of truth and accuracy, signed and dated by an officer of the mortgagor, and the criminal certification which appear on the back of Form HUD-92417. The certifications must reference the name of the mortgagor entity and the date of the statement.

B. Long Form Cost Certification. Use Mortgagor's Certificate of Actual Cost, Form HUD-92330 supported by an accountant's opinion in all cases that do not qualify for simplified cost certification outlined in paragraph 11-6.A.1.

1. Contractor's Certificate of Actual Cost, Form HUD-92330A, supported by an accountant's opinion, is required for all projects where there is an identity of interest with the mortgagor and/or where a cost plus construction contract was used, unless the project qualifies for simplified cost certification.

(11-6) a. Subcontractors, suppliers and equipment lessors with an identity of interest with either the mortgagor or general contractor, who is required cost certify, must submit Form HUD-92330A supported by an accountant's opinion. Refer to Note in paragraph 11-6.A.2.

b. Form FHA-2330A(LI), Contractor's Certification of Actual Cost, is a special certification for land improvement developments such as Mobile Home Courts.

2. An audited balance sheet of the mortgagor entity, as of the cut-off date, which is prepared in accordance with the General Accounting Office's Governmental Auditing Standards, Standards for Audit of Governmental Organizations, Programs, Activities, and Functions (the GAO Yellow Book), is required in all cases.

a. The balance sheet must contain the certification of truth and accuracy, signed and dated by an officer of the mortgagor entity, and the criminal certification reflected in paragraph 3-2.B.1 above. The certifications must reference the name of the mortgagor entity and the date of the statement.

b. If short-term liabilities on the balance sheet do not agree with Column B of Form HUD-92330, reconciling information must be furnished.

c. The mortgage payable must agree with HUD records on both disbursed and undisbursed portions.

d. All other liabilities must be in the form of HUD-approved promissory notes. (See Chapter 12.)

e. Debt to a third party who made the original disbursement for an item listed as paid on Mortgagor's Certificate of Actual Cost, Form HUD-92330, must either be paid at final

(11-6) endorsement or considered in the escrow for unpaid items which is set up at final endorsement (see paragraph 11714.B).

f. The purpose of all liabilities must be fully explained in the notes to the financial statements. This information must include repayment requirements of the liabilities.

g. If the proceeds and obligations arising from project syndication are passed through the books and records of the mortgagor entity:

(1) Receivables should be reflected as an asset of the mortgagor entity.

(a) The cash payment or receivable is not considered in the computation of surplus cash/residual receipts since the funds were not generated from the operation of the mortgagor entity.

(b) The funds are considered due the general partner and, at his/her discretion, may be used to prepay HUD-approved promissory notes.

(2) Liabilities incurred in project syndication and not repaid from syndication proceeds at final endorsement, must be evidenced by a HUD-approved promissory note.

h. See Chapter 15 for special instructions concerning bond financed cases.

i. See Chapter 18 for special instructions concerning projects involving Low Income Housing Tax Credits (LIHTCs).

3. Audited operating statement is required if occupancy occurred during construction; otherwise, a statement advising that there was no occupancy during the construction period must be present.

a. The statement must contain the certification of truth and accuracy, signed and dated by an officer of the mortgagor, and the criminal certification reflected in

(11-6) paragraph 3-2.B.1 above. The certifications must reference the name of the mortgagor entity and the date of the statement.

b. The operating statement is prepared on an accrual basis. Revenue is recognized when it is earned and expenses are recorded as they are incurred, without regard to the timing of the receipt or payment.

c. The period covered is from the beginning of marketing and rent-up activities (or date of initial endorsement in rehabilitation projects involving insurance of advances or start of construction in cases involving insurance upon completion where occupancy is continuous) to the cut-off date.

(1) Marketing and rent-up activities will start no earlier than 6 months before the issuance of the first Permission to Occupy-Project Mortgages, Form HUD-92485.

(2) 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."

d. The notes to the financial statements must provide the following information relative to the working capital deposit:

(1) The original amount of the deposit.

(2) Expended portion of the working capital deposit:

(a) Must be supported by a schedule setting forth the vendor's name, a description of items purchased, total invoice price and the amount paid to date.

(b) Examples of items paid from the working capital deposit:

(11-6) 1 Cost of initial marketing and rent-up, i.e., sales and advertising, model furnishings and equipment and supplies essential to initial rent-up.

2 Escrows for items due during the first operating year that project income is not expected to cover, i.e., real estate taxes, permanent property insurance premiums, mortgage insurance premium, ground rents, and assessments.

3 Shortfalls in interest, taxes, property insurance premiums, mortgage insurance premiums, ground rent and assessments when funds available for these purposes under the Building Loan Agreement have been exhausted.

e. The statement must show income from all sources. Do not consider security deposits as income.

f. Any income received during construction that is not a result of project operations, i.e., income resulting from the investment of insurance proceeds, should be identified in the notes to the financial statement whether or not occupancy occurred during construction.

g. See if the operating statement contains any expense items that were paid or should have been paid from the working capital deposit, AMPO or otherwise included in cost certification. If so, adjust the net income in the statement.

h. Operating expenses may include:

(1) Expenses directly relating to renting the project may include, but are not limited to:

(a) Rental commissions customary for the type of project, if any; and

(11-6) (b) Marketing and advertising expenses.

(2) Purchase of furnishings, equipment and supplies essential to project operation.

(3) Reasonable fees for preparing any Federal, State or local tax return information required of the project.

(a) For example: If the mortgagor entity is a partnership, the cost of preparing both Form 1065, U. S. Partnership Return of Income, and related K Schedules may be considered.

1 Schedule K, Partners, Share of Income Credits, Deductions, Etc., lists the partnership's distributive share of income, deductions, credits and tax preference items.

2 Schedule K-1, Partner's Share of Income Credits, Deductions, Etc. (Individual), identifies each partner's share of those accounts.

3 Do not recognize the cost of preparing a partner's personal Form 1040 return.

(b) If the project is owned by an individual, the project can pay for preparation of any tax return schedule related to project operations but not other parts of the owner's return.

(4) Electricity, gas, water and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.) to the extent they are not included in construction cost on Forms HUD-92330, Mortgagor's Certificate of Actual Cost or HUD-92330A, Contractor's Certificate of Actual Cost.

(11-6) (5) Management fee stated in the management contract.

(6) Services not covered by the management fee under paragraphs 3(b) and (c) 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, because it is an accounting procedure to expense the cost of the physical structure of the project over a period of time and does not involve actual disbursements.

(2) Interest, taxes, property insurance premiums, and mortgage, insurance premiums, that are reflected in Form HUD-92330, Mortgagor's Certificate of Actual Cost.

(3) Salaries paid to principals of the sponsor or mortgagor for managing the mortgagor entity.

j. Part II of the Housing Assistance Payments Contract, Form HUD-52522-D, dated 1-90.

(1) Requires the owner to start making deposits to the replacement reserve on the effective date of the contract.

(a) For staged projects, the obligation will begin on a pro rata basis for units in each stage, on the effective date of the contract for that stage.

(b) This is not applicable to partially assisted or previously HUD-Owned projects.

(2) Treat the deposits as a reduction to gross operating income of the project.

(11-6) k. Treat net income resulting from review of operating statement and any income identified in the notes to the financial statement based on paragraph f above as follows:

(1) Profit motivated mortgagor as a recovery of construction costs (on Form FHA-2331A, Cost Certification Review Worksheet - Mortgage Credit Staff).

(2) Nonprofit mortgagor:

(a) At cost certification, as a recovery of construction costs to the extent it was used to reduce liquidated/actual damages.

(b) As an offset for any eligible mortgage increase.

(c) At final endorsement, deposit the unused portion of net income to the reserve fund for replacements.

1. If operating expenses exceed income:

(1) No entry is made on Form HUD-92330, Mortgagor's Certificate of Actual Cost.

(2) Operating deficit may be carried over as a reduction to net income on the supplemental operating statement required by paragraph 11-15 below.

4. 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 balance sheet and operating statement of the mortgagor, and Form HUD-92330A, Contractor's Certificate of Actual Cost.

a. The accountant must be independent within the meaning of the code of professional ethics of the American Institute of Certified Public Accountants (AICPA).

(11-6) b. The independent Public Accountant must have been licensed by a regulatory authority of a State or other political subdivision of the United States before December 31, 1970.

c. 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.

d. Determine the adequacy of the accountant's opinion.

(1) Return any certification that is:

(a) Inconsistent with the suggested format in paragraph 6-6 of Reference 1 of the Foreword, since it contains the minimum representations acceptable to HUD. The certification must include the following references:

1 The examination has been conducted following generally accepted auditing standards and the standards set forth in the GAO Yellow Book.

2 The audit has been planned and performed to obtain reasonable assurance that the financial statements are free of material misstatement.

3 "The mortgagor's Certificate of Actual Cost and the financial statements, referred to above, present fairly the actual costs of (identify mortgagor), through (identify cut-off date), the assets, liabilities and project equity, as of (identify cut-off date), and the results of project operations for the period from date of marketing and rent-up activities (initial endorsement

(11-6) for substantial rehabilitation projects involving continuous occupancy) through (cut-off date)."

4 The accountant must have no business or financial relationship with the mortgagor or general contractor except for the performance of the audit.

(b) From an ineligible accountant.

(2) Certification date must not predate the date the mortgagor and/or general contractor sign the certificate(s) of actual cost.

(3) Establish that the public accountant is licensed.

(4) Qualifying statements may make the certification unacceptable.

(a) Statements such as the following make the certification unacceptable:

1 "Prepared from the books without audit."

2 "Because of the unavailability of certain records, we are unable to express an opinion."

3 "Based on information furnished by the client, which we have no reason to question."

(b) Qualifications other than those cited above must be supported by explanation from the accountant. Evaluate the explanation for acceptability.

11-7. EVALUATION OF THE COST CERTIFICATION SUBMISSIONS

A. The Director of Housing Development's primary responsibilities are:

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(11-7) 1. To require careful review of Forms HUD-92330 and HUD-92330A for mathematical accuracy and compliance with prescribed procedures.

2. To 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, MIP, title and recording, financing fees, legal, organizational and audit fees, offsite costs and other fees.

3. To require clarification or breakdown of all, or any part of, the cost figures presented by the mortgagor or general contractor.

4. To question the existence of any identity of interest subcontractor, material supplier or equipment lessor.

5. Request an audit of the mortgagor's and/or contractor's books by the Regional Inspector General for Audit before issuing Form FHA-2580, Maximum Insurable Mortgage, when differences of opinion arise from other than:

a. Genuine misunderstanding of HUD instructions.

b. Honest differences of opinion clearly identifiable as such.

c. Other justifiable causes.

B. 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 such as gas and electricity, clean-up costs, etc., between construction and operation periods.

2. Insist on reasonable allocation(s) and eliminate duplicate claims for the expenses under both categories.

C. When the cost certification package is received for processing:

(11-7) 1. The Cost and Mortgage Credit staffs will:

a. Determine deficiencies associated with the mortgagor's and contractor's cost certifications.

b. Advise the Director of Housing Development and estimate the time needed to resolve the problem(s).

c. 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.

d. Send a letter within 5 workdays to the mortgagor with copies to the general contractor (if applicable), their accountants, and the mortgagee stating the deficiencies and requesting information.

2. Upon receipt of all necessary information, combined processing should not exceed 15 workdays.

3. If the mortgagor or contractor indicates clarification will be forwarded within a very few days, the conclusions of cost certification can await the additional information.

4. If final resolution requires extended delay, the Director of Housing Development must require that the review be completed, tentatively disallowing any costs for which adequate clarification has not been received.

a. Note any tentative disallowances with asterisks in the disallowed column as well as in the "remarks" section of Form FHA-2331A, Cost Certification Review Worksheet, Mortgage Credit Staff.

b. Attach a memorandum concerning the tentative disallowances made on Form FHA-2331A, giving a full explanation of the information needed to resolve remaining questions.

c. Issue Form FHA-2580 where the combined effect of tentative and firm disallowances would not decrease the mortgage.

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(11-7) d. The Director of Housing Development will notify the mortgagor and mortgagee of the needed information. The letter should:

(1) Indicate items tentatively disallowed and later approved will have no effect on the maximum insurable mortgage but could cause a recomputation of the mortgagor's initial equity investment.

(2) Establish a 30-day deadline for receiving the clarifications.

11-8. FORM FHA-2331, SUMMARY OF COST CERTIFICATION REVIEW COST SECTION, "MEMORANDUM," completed by Cost gives an opinion on all items of cost claimed on Form HUD-92330A, and any cost on Form HUD-92330 needing Cost staff review, i.e., other fees. Upon receipt of this memorandum, complete Form FHA-2331A.

11-9. MORTGAGE CREDIT EXAMINATION determines the maximum insurable mortgage based on actual cost of the completed project.

A. Advise Cost of any construction costs included in "Miscellaneous" and "Other" categories of Form HUD-92330.

B. Check items and amounts in the mortgagor's cost certification without auditing the mortgagor's books and records. An audit may be needed later. (Refer to paragraph 11-7.A.5.)

C. Record the results of the review on Form FHA-2331A, Cost Certification Review Worksheet.

11-10. ALLOWABLE COSTS IN FORM HUD-92330, MORTGAGOR'S CERTIFICATE OF ACTUAL COST.

A. Construction Contract:

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

a. Actual cash paid or to be paid by the mortgagor under the construction contract.

(11-10) b. Contract price as adjusted by HUD's estimated cumulative effect of approved change orders paid, or to be paid, by the mortgagor and the liquidated/actual damages provision (refer to paragraph 6 below) of the contract, if applicable.

2. A cost plus construction contract is required:

a. When an identity of interest exists between the mortgagor and general contractor.

b. For a nonprofit mortgagor, unless it is established, to the Commissioner's satisfaction before initial endorsement, that a cost plus form of contract is not needed to protect HUD's interest and the interest of the mortgagor.

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 mortgagor under the construction contract.

b. Amount the cost analyst allowed for construction on Form FHA-2331, Summary of Cost Certification Review - Cost Section.

c. Contract price as adjusted by the HUD estimated cumulative effect of approved change orders paid, or to be paid, by the mortgagor 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., unless they are

(11-10) determined by the A, E & C staff to be necessary changes as defined in paragraph 11-11.B.1.d. below.

(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) Under those Sections of the Act for which BSPRA is not applicable, for profit motivated projects involving an identity of interest between the mortgagor and general contractor, the amount of builder's profit as shown on Form HUD-3305 or -3305A is eligible whether or not it was paid in cash.

(5) For nonprofit mortgagors, 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 mortgagor in the general contractor or any financial interest of the general contractor in the mortgagor.

b. Any officer, director or stockholder or partner of the mortgagor is also an officer, director or stockholder or partner of the general contractor.

(11-10)c. Any officer, director, stockholder or partner of the mortgagor 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 mortgagor.

d. The general contractor advances any funds to the mortgagor.

e. The general contractor supplies and pays, on behalf of the mortgagor, 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 mortgagor corporation as consideration of payment.

g. There exists or comes into being any side deals, agreements, contracts or undertakings entered into or contemplated, thereby altering, amending, or cancelling any of the required closing documents, except as approved by the Secretary.

h. Any relationship (e.g., family) existing which would give the mortgagor 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. The construction contract may be modified before initial endorsement to provide for a contractor's incentive when construction is completed before the date specified in the construction contract (as amended by HUD approved time extensions).

a. Identity of interest mortgagor and general contractor.

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(11-10)(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.

b. Nonidentity of interest mortgagor and general contractor.

(1) Use Construction Contract Incentive Payment, Form HUD-92443.

(2) Include the incentive payment under "Other" on Form FHA-2331A.

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 changes orders) through the final 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 HUD approved time extensions, through the final completion date.

d. Reduce the damages by the portion of the net operating income earned during the liquidated/actual damage period.

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(11-10) (1) Ask the mortgagor to submit a separate operating statement for the period of damages to determine the amount of damages to be assessed.

(2) If the statement for the period of damages is unattainable, prorate the net operating income from date of marketing or rent-up activities (date of initial endorsement in substantial rehabilitation projects where occupancy is continuous) through the final completion date.

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 final completion.

7. If a mortgagor acts as its own general contractor:

a. A construction contract is not executed. Instead, Form FHA-2441-Supplement, is added to the Building Loan Agreement, Form HUD-92441.

b. The upset price for construction is line 51 of the approved Form FHA-2328, Contractor's and/or Mortgagor's Cost Breakdown (Schedules of Values), as adjusted by the cumulative effect of HUD-approved change orders and the incentive provision, if applicable.

c. Incentive clause, if any, is incorporated by addendum to Form FHA-2441-Supplement.

d. There is no liquidated/actual damages clause.

NOTE: The mortgagor may serve as its own general contractor only when the mortgagor is an individual or a general partnership.

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(11-10) 8. Incomplete Minor Items. The mortgagor's

certification of the amount due under the terms of the construction contract may include the cost of minor items of on-site work which 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, AIA Document B181. Ask the A, E & Cost Branch to check the reasonableness of these charges.

EXCEPTION: Architects of Section 202/811 projects are not permitted to request added monies for reimbursable expenses and additional services beyond compensation provided for basic services.

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 in to being between the architect and either the mortgagor 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-3305/3305A/3306/3306A.

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 FHA-2580.

C. Interest is allowable in the amount accrued on the first mortgage, (improvement loan under Section 220(h), or supplemental loan under Section 213 or

(11-10)241) between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in paragraphs 11-4 and -5.

1. Recognize interest costs associated with an approved early start provided:

a. The mortgagor entered into an agreement with the contractor which:

(1) Was approved by the Director of Housing Development.

(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 mortgagor 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 mortgagor, does not exceed the total amount of interest estimated in Section G of Form HUD-92264.

c. Form FHA-2415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, was executed and approved.

d. Interest costs reflects 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 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.

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(11-10) b. For insurance upon completion -- the rate acknowledged by the Director of Housing Development before issuing the firm commitment. See paragraph 10-5.A.

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 mortgagor or sponsor, as a direct mortgage reduction to the original mortgage amount on Form FHA-2580.

5. If the construction interest rate changes before initial endorsement and it was not feasible to reprocess the project or if a State Housing Agency sold bonds 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 condition in paragraph 5-2 was included in the commitment.

6. Neither the interest on subordinated liens nor other obligations of the mortgagor, are allowed as certifiable costs.

D. Taxes are allowable in the amount accrued during the same period identified in paragraph C above. Do not recognize costs accrued during early start period.

E. Property insurance is allowable in the amount accrued during the same period identified in paragraph C above. Do not recognize costs accrued during early start period.

F. Mortgage Insurance Premium (MIP). The Office of Finance and Accounting 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.

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(11-10) 1. For a project involving insurance of advances,

allow MIP of 1/2 of 1 percent per annum on the mortgage amount on the basis of accrual for the number of days in the period used in 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, FNMA or GNMA or other permanent lender commitment and marketing fees, and other similar fees.

1. Allow the lesser of:

a. Amounts paid, or to be paid, in cash.

b. Amounts shown on Form HUD-2434, Mortgagee's Certificate, or Certificate of Mortgagee portion of Form FHA-2455 and approved by the Director of Housing Development before initial endorsement (insurance of advances) and issuance of firm commitment (insurance upon completion), respectively.

2. Construction lender's initial service charge (usually 2 percent):

a. Is expected to cover:

(1) Processing fees.

(2) Expenses of lender's counsel.

(3) All other charges by the construction lender.

b. Excludes:

(1) Construction loan discount.

(2) Construction loan extension fees.

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(11-10) c. Any charges made by the lender for payment

of counsel, or charges paid directly to the lender's counsel, to the extent they cause the initial service charge to exceed 2 percent, are not certifiable. Charges related to "Title and Recording" expense are certifiable under that line item.

3. Permanent lender's placement fee (usually 1.5 percent):

a. Is expected to cover all permanent placement expenses except discounts and some of the fees associated with a bond financed transaction.

b. If GNMA Mortgaged Backed Securities are involved, the mortgagee may not assess an additional charge for the MBS application fee or for the custodial or delivery fee.

NOTE: Construction and Permanent lenders' fees in the aggregate shall not exceed 3-1/2 percent and may be divided as agreed upon by the parties involved.

4. Recognize for cost certification:

a. Reasonable discounts (based upon current interest rate levels at the time of initial closing for projects involving insurance of advances and issuance of the firm commitment for projects involving insurance upon completion) charged by the construction and permanent lenders and extension fees charged by the construction lender, if funded at initial endorsement and shown on the Mortgagee's Certificate, Form HUD-2434.

b. Permanent lender extension fees, shown on Form HUD-2434, if funded before the final completion date.

c. For insurance upon completion cases, construction and permanent loan extension fees, shown on the Certification of Mortgagee portion of Form FHA-2455, if funded before cost certification cut-off.

d. Financing fees (including extension fees and discounts) paid on behalf of a mortgagor by a third party under paragraph 18f of the

(11-10) Mortgagee's Certificate or paragraph 10h of Certificate of Mortgage portion of Form FHA-2455 and shown as a current liability on the mortgagor's balance sheet to the extent there are savings in the mortgage. At final endorsement:

(1) Escrow enough funds to pay back that portion of the outstanding loan recognized in cost certification.

(2) Require a promissory note be used for the remainder of the obligation.

e. For bond financed projects, cost of issuance, discounts and financing fees in excess of 3-1/2 percent provided the cost certification evidences that the sponsor/mortgagor could not benefit monetarily from excess investment income from the proceeds of the invested obligations. Refer to paragraph 15-4.

5. Do not recognize for cost certification:

a. Any "side deals" (except for approved discounts) by which the mortgagor agrees to pay for "added cost of money."

b. The cost of purchasing of FNMA stock.

c. The 4 percent construction loan and 1.75 percent permanent loan GNMA indemnification escrows.

d. Discounts required to buy down the construction and/or permanent rate to a below market rate.

6. Treat the following as a direct mortgage reduction at final endorsement:

a. Premiums paid by lender to the mortgagor or sponsor for acquiring the construction or permanent loan.

b. Partial refunds of the commitment fee allowed in processing, which are returned to the mortgagor or sponsor.

(11-10) 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 mortgagor or sponsor by the lender/bond underwriter for bond financed mortgages.

I. Title and recording expense is 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 mortgagor entity, developing the proposal to submit to HUD and other necessary governmental agencies and required services during closings and construction.

1. Organizational allowance:

a. Allow only the amount included in Section G of Form HUD-92264 for organizational fee, unless fully supporting documentation is submitted by the mortgagor which justifies the need for and reasonableness of the additional expenditure.

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 FHA-2580.

2. Allow a consultant's fee if it was included in replacement cost on Form HUD-92264 for a nonprofit mortgagor. Limit the consultant's fee to the lesser of:

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(11-10) a. Amount specified in Form HUD-92531-A,
Standard Contract for Housing Consultant
Services for Nonprofit Projects Under HUD
Programs Exclusive of Section 202.

b. Amount actually paid or to be paid in cash.

c. Amount allowed in processing.

3. Limit legal expenses to those incurred for:
initial through final closings; tax advice
during organization of mortgagor entity only;
and preparation of documents and representation
for and during organization of the mortgagor
entity.

a. Allow customary expenditures expected to be
incurred before and during initial closing,
construction period, and final closing.

b. Do not allow:

(1) The usual expenses connected with land
acquisition which are 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.

4. 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.

5. Audit fee covers the cost of the accountant's
audit and opinion of the mortgagor's certificate
of costs.

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(11-10) 6. 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. Nontypical fees must be borne by the mortgagor, unless in an exceptionally complex case, a higher fee is proven by the mortgagor 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 are performed by the same firm.

7. For coops, see the Cooperative Housing Handbooks 4550.1 through 4550.6 since special instructions apply.

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

1. Contract price as adjusted by the 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 on Form FHA-2331, Summary of Cost Certification Review-Cost Section.

NOTE: (1) 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.

(2) Offsite cost is not allowable for leasehold estates when the ground rent is based on a land value that reflects all required offsite improvements since those improvements have not been paid for by the mortgagor.

(11-10) 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 mortgagor, 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 used in paragraph C above.

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 mortgagor. If the construction contract contained an amount for the bond premium, subtract it from the contract when developing the adjusted upset price on line 1c of Form FHA-2331A.

6. Other fees, including engineering and topographical survey. A, E & C Branch must determine if such costs are reasonable and not duplicated in the general contractor's costs.

7. Supplemental management fund established on Form HUD-92264.

a. Allow the entire amount.

b. The supplemental management fund is not included in the computation of BSPRA.

c. At final endorsement, place unused funds in an escrow account held by the mortgagee to be disbursed only upon approval of the Director of Housing Management.

(11-10) B. Contingency reserve is included in the replacement cost of substantial rehabilitation projects.

a. Refer to paragraph 9-1.C for acceptable uses of contingency reserve funds.

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.

9. Grants/loans to the mortgagor entity and/or principals of the mortgagor entity used to pay for allowed items of cost.

a. Treat as a recovery of cost after BSPRA.

b. Do not deduct grant/loan funds used to pay for nonreplacement cost items, i.e., grant/loan proceeds used to pay the acquisition cost of the land in excess of the HUD allowance are not deducted from the total recognized costs.

10. Residential relocation fund established on Form HUD-92264. Allow only those expenses approved by the CPD relocation specialist up to the amount established on Form HUD-92264. Apply unused allowance as a direct mortgage reduction.

M. Allowance for making nonprofit projects operational (AMPO) is included in the replacement cost of the project under certain sections of the Act involving nonprofit mortgagors. (See Chapter 8 for the uses of AMPO.)

1. All expenditures covered by the allowance must be itemized in the certification of actual costs.

(11-10) 2. In insurance upon completion cases, mortgage proceeds are released at closing to reimburse the mortgagor for the expenditures determined allowable.

3. Take care not to recognize expenditures that are included in other line items, i.e., change orders, overruns for soft costs, etc.

4. Expenses paid from the allowance are not to be included in the operating statement or in the certified cost for any other line item.

5. At final endorsement, transfer any unexpended AMPO funds to replacement reserve fund.

N. Builder's and Sponsor's Profit and Risk Allowance (BSPRA) is allowed under Sections 220, 221(d)(3), 221(d)(4), 231, and 236 of the Act.

1. HUD does not control the division of BSPRA.

2. Compute without regard to amounts on Form HUD-92264. Base the BSPRA computation on a percentage of allowed costs.

a. Use the same percentage (not to exceed 10 percent) used to compute BSPRA in the firm commitment processing.

b. Exclude from the computation the cost of offsites, land, payments for acquisition of a leasehold, ground-rent, relocation expenses, any supplemental management funds, and major moveable equipment, if applicable.

3. Fifty/seventy-five percent 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 percent of the contract sum in the Construction Contract-Cost Plus, Form HUD-92442-A, is subcontracted to one subcontractor, material supplier or equipment lessor, or

(11-10)(2) Seventy-five percent or more with three or less subcontractors, material suppliers and equipment lessors.

b. Exceptions. The "50 percent - 75 percent" rule is not applicable to:

(1) Manufacturers of Industrialized Housing.

(2) Trade items performed by persons on general contractor's payroll.

(3) Mobile Home Park program.

(4) Supplemental Loan program.

(5) Rehabilitation programs other than gut rehabilitation.

c. The Cost Analyst determines the applicability of the 50 percent - 75 percent Rule.

d. Where the "50 percent - 75 percent" 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 mortgagor and builder or when the "50 percent - 75 percent" rule has been violated, compute a SPRA which is 10 percent of allowable:

a. Architectural fees.

b. Carrying charges and financing.

c. Legal, organization and audit expenses.

5. If an identity of interest between the mortgagor and general contractor is established after initial endorsement and exists at the time of final completion, BSPRA is allowed in lieu of a builder's profit and SPRA.

6. If prior to the final completion date an identity of interest no longer exists between the mortgagor and builder, substitute SPRA for BSPRA.

(11-10) 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 FHA-2580.

11-11. INCREASE IN MORTGAGE AMOUNT.

A. Timing. Generally, requests for a mortgage increase should not be considered until the project is complete, cost certification and subsequent review is complete, and final endorsement will likely be achieved immediately following processing of the mortgage increase.

B. Bases for considering mortgage increase. (Refer to Handbook 4435.1.) To cover:

1. Necessary changes that arise from:

a. Differing site conditions (as defined in the construction contract).

b. Compliance with local codes.

c. Unforeseen conditions that may affect the safety and health of occupants.

d. Betterments that are economically justified (e.g., those that produce significant cost savings to project operation, can be reflected in increased income expectancy, or enhance the security of the mortgage).

2. 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.

3. Other costs not known at firm commitment resulting from requirements of local authorities and beyond the mortgagor's control.

4. Construction (hard) cost increases caused by a natural disaster declared by Federal or State government, to the extent not covered by casualty insurance.

5. Increased costs resulting from concealed subsurface site conditions, provided it is determined that exploratory tests during project design were sufficient and thorough and neither the architect nor engineer were at fault.

6. Cost of substituting a general contractor when the original general contractor is terminated for cause and the surety has failed to perform. (Report any nonperformance by a surety to HUD Headquarters, Office of Insured Multifamily Housing Development.)

7. To correct a substantial HUD error in the original processing which would otherwise result in serious inequities.

C. Any mortgage increase for an insured project must be more than 2-1/2 percent of the original mortgage and at least \$50,000. Not applicable to Section 202 Direct Loan Program or Section 202/811 Capital Advance Program.

D. Recruited Action

1. General. Before processing any request for an increase, ensure that it is eligible under paragraph B above. All increases are to be fully justified and the project files documented as to the action taken.

a. Analyze the reasons for the increase and evaluate the project's potential success in reaching endorsement if the increase is approved.

b. Consider what other solutions are possible (e.g., infusion of new capital through new partners, syndication proceeds, etc.).

2. Processing. Prepare a second Form FHA-2331A to reflect costs eligible for the mortgage increase.

a. Compute the allowable construction cost, line 1d of Form FHA-2331A. Reduce this amount by the cost attributable to any change order(s) not qualifying for a mortgage increase. The adjusted allowable construction cost forms the basis of the mortgage increase computation.

(11-11)b. If it is determined that a HUD error in processing involving incorrect construction cost estimates has been made and a mortgage increase has been processed to correct the error, do not use the adjusted upset price of the construction contract as a limiting criterion for the amount to be recognized at cost certification for construction. The initial allowable construction costs will be based upon the lesser of:

- (1) The amount of the construction cost certified by the mortgagor; or
- (2) The upset price of the construction contract as adjusted by approved change orders eligible for a mortgage increase plus any corrections of errors in the original processing.

c. Determine eligible amounts for: Architect's fees, bond premium if paid by the mortgagor, other fees not included in the construction contract and paid by the mortgagor, interest, taxes, insurance, title and recording, AMPO (if applicable), legal, organizational and audit fees, consultant's fees (if applicable), supplemental management fund (if applicable), offsite costs and "as-is" land value.

- (1) Do not increase BSPRA or restore contingency reserve or AMPO/project contingency.
- (2) Do not include nonmortgageable items (construction or permanent loan extension fees; discounts; rate maintenance fees, etc.)
- (3) Do not recognize organizational fees in excess of the allowance included in Section G of Form HUD-92264.
- (4) Offset nonmortgageable items by net income earned during the construction period.
- (5) Apply any remaining net income to offset amount of mortgage increase.

(6) For increases caused by natural disaster:

(a) The revised cost should consider increased carrying charges, financing fees, and legal fees. Do not include any cost due to construction delays before the disaster.

(b) Reduce the new estimated replacement cost by the amount of any actual recovery of insurance proceeds plus interest, if any, on the investment of these proceeds.

(c) Require prepayments to be made for any late recovery of insurance proceeds.

(7) For increases caused by errors or omissions of the architect, require prepayments to be made if late recovery of damages is received.

(8) Provide these amounts to the Valuation Branch for use in revising Form HUD-92264.

(9) Using the revised Form HUD-92264, prepare a revised Form HUD-92264-A.

d. The application fee, inspection fee and MIP will be based upon the increased mortgage.

3. The portion of the mortgage attributable to the increase may have a construction and permanent interest rate greater or less than the original rates. Use the blended rate determined by the Valuation Branch in processing Criterion 5 of Form HUD-92264-A if there is a difference in rates.

4. A mortgage increase does not change the maturity date of the mortgage.

11-12. DETERMINING THE MAXIMUM INSURABLE MORTGAGE. Complete, Form FHA-2580, Maximum Insurable Mortgage, following instructions in Reference (16) of the Foreword.

(11-12) A. A mortgage reduction, when the total cumulative effect of approved change orders is negative, may cause definite hardship to the mortgagor when replacement cost is not the controlling mortgage criterion.

1. Mortgagee must request that the mortgage not be reduced.

2. Director of Housing Development may approve the request if a reduction in the replacement cost resulting from construction changes would not otherwise reduce the original committed mortgage.

3. Field Office will:

a. Process a new Rental Housing Project Income Analysis and Appraisal, Form HUD-92264.

(1) Reduce the total estimated replacement cost reflected in the firm commitment processing by the total negative effect of approved change orders.

(2) If a reprocessing was previously performed due to the approval of change orders which had an unfavorable effect on net income, consider the adjusted rents and/or expenses in the reprocessing.

b. Recalculate the mortgage by reprocessing Form HUD-92264-A and compare with original committed mortgage to determine if a reduction is warranted.

c. If reduction is not warranted, issue Form FHA-2580 reflecting no mortgage reduction attributable to negative change orders.

4. This procedure may also be used where there are:

a. Unused contingency reserve funds.

b. Savings in architect's fee(s).

c. Unused relocation allowance funds.

d. Unused project contingency funds.

(11-12) e. Savings in interest. (Refer to paragraph 11-10.C.5.)

f. Lender's/bond underwriter's refund of construction interest. (Refer to paragraph 11-10.C.4.)

g. Lender's/bond underwriter's contribution of part of the initial service charge to pay discounts or other fees.

h. Premiums paid by the lender for acquiring the construction or permanent loan financing.

i. Any refund of the commitment fee included in processing.

j. Savings resulting from the substitution of SPRA and a builder's profit for BSPRA at cost certification.

B. Determine the mortgagor's initial equity investment as follows:

1. New construction and substantial rehabilitation projects under Sections 220 and 221(d): Line 6, Form FHA-2580, minus the maximum insurable mortgage determined in line 10 of this Form.

2. Rehabilitation-Property Owned (except under Sections 220 and 221(d)): Reduce the sum of line 4, Form FHA-2580, plus HUD's estimate of the "as is" value of the existing land and improvements before rehabilitation, by the maximum insurable mortgage determined in line 10 of this Form.

3. Rehabilitation-Property Acquired (except under Sections 220 and 221(d)): Reduce the sum of line 4, Form FHA-2580, 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 maximum insurable mortgage determined in line 10 of this Form.

4. The amount determined by paragraphs 1, 2 or 3 may be increased by:

(11-12) a. Expended working capital funds not recognized in the cost certification review. Refer to paragraph 11-6.B.3.d and g.

b. Residential relocation expenses approved by the CPD relocation specialist in excess of the amount established on Form HUD-92264, Section G.

c. Send signed original to the mortgagee and a signed copy to the mortgagor.

d. Place copies of Forms FHA-2331, 2331A and 2580 in the Field Office Docket and Washington Docket with copies of the cost certification exhibits. Additional copies go to the closing attorney and Valuation data bank.

11-13. COST CERTIFICATION INCONTESTABLE. All items approved on Form FHA-2580 are final and incontestable as of the date Form FHA-2580 is issued by HUD, except when fraud or material misrepresentation occurs by the mortgagor, general contractor or subcontractors.

11-14. MORTGAGE REDUCTION AFTER COST CERTIFICATION

A. Adjustments for Undetermined Costs and/or Escrows

1. The law requires that the mortgage will not exceed the applicable percentage of actual costs.

2. The Agreement and Certification, Form HUD-3305/3306, provides that where the Commissioner accepts, for cost certification, estimates of cost for any item, the later substitution of certified actual costs may require a reduction of the mortgage.

3. Reductions of cost may arise from:

a. Refunds, rebates, or discounts.

b. Excess of escrows over the actual costs of incomplete construction items.

c. Refunds of deposits made by the mortgagor to prevent losses to the mortgagee from loss in connection with sale of the mortgage.

(11-14) d. Settlement of claims against bonding companies or others after project completion.

B. At final endorsement, the mortgagor must set up a cash escrow to pay all "to be paid in cash items" identified on Form HUD-92330, Mortgagor'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 FRA-2023, Request for Final Endorsement of Credit Instrument or FHA-2455 (For Insurance Upon Completion Projects only).

b. The "to be paid" column on Form HUD-92330 plus debts to third parties.

2. Difference must be supported by paid receipts and a statement from the mortgagor identifying by name and cost, those items paid in cash. The receipts and statement are affixed to Form FHA-2023/2455.

3. Do not accept personal or business checks issued by the mortgagor at final endorsement as evidence of payment. Payment must be in certified or cashier checks.

4. Prepare a new Form FHA-2331A 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 FHA-2580 from the total of HUD-approved cost of revised Form FHA-2331A.

5. Undisbursed mortgage proceeds may supplement or satisfy the cash escrow.

6. Use Form HUD-92476-1, Escrow Agreement for Unpaid Construction Costs:

a. To set up the cash escrow.

b. Attach a detailed listing of the unpaid costs.

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(11-14) 7. Use Form HUD-92464, Request for Approval of Advances of Escrow Funds, to disburse escrow.

8. Escrow should be disbursed within 45 days after final endorsement. If all of the funds are not disbursed follow the procedures in C below.

9. At final endorsement, if all obligations have been paid in cash, nothing else is needed.

C. Sixty days after final endorsement:

1. Prepare a new Form FHA-2331A. Enter under the column heading:

a. "2264" - the amount of each item of cost recognized from the earlier Form FHA-2331A "Allowed" Column.

b. "2330/2330A" - the amounts listed in Column C of the Mortgagor's Certificate of Actual Cost, Form HUD-92330, for each item of cost.

c. "Allowed" - the amounts paid in cash balled on the reconciliation performed in paragraph 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 FHA-2580, based on the total of the "Disallowed Column" (Form FHA-2331A). If this computation produces an amount less than the mortgage finally endorsed:

a. Notify the Directors of Housing Development and Management 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 Fund.

(11-14) c. If the Field Office 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 mortgagee or escrow agent by letter 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 Field Office.

3. The mortgagee 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.

D. 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.

11-15. SUPPLEMENTAL INCOME STATEMENT. This passage doesn't apply to cooperative, investor-sponsor, or nonprofit mortgagors, nor to any project where the mortgage is \$200,000 or less.

A. A supplemental operating statement is required for the period from the cost certification cut-off date to the date which is 3 months before the start of amortization. The supplemental statement must be prepared and certified by a CPA or IPA if the original cost certification was required to be audited.

1. No supplemental statement is needed when less than 3 months exist between the cut-off date and the start of amortization.

2. If a deferment of amortization has been granted use the new date for the start of amortization in determining the need for a supplemental operating statement.

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(11-15) B. Mortgagor may advance the date of amortization to avoid submitting a supplemental income statement.

C. When the final closing is scheduled:

1. After the close of the accountability period, the statement should be submitted before final closing.

2. Before the expiration of the accountability period, the mortgagor must agree in writing:

a. To furnish an operating statement for the period within 30 days after its expiration.

b. To immediately apply, as a mandatory prepayment to the mortgage, such portion of the net operating income as the Commissioner may require.

D. In preparing this statement, mortgagors:

1. Must include as income all rents received, exclusive of security deposits.

2. May deduct from net income all expenses for operations, including, interest, taxes, insurance, MIP, and management fees as stated in the management contract, except:

a. Amounts included in the mortgagor's cost certification including those costs certified to under AMPO or working capital expenditures.

b. Depreciation.

c. Officer's/board member's salaries.

3. After adjustment, if the operating statements submitted at cost certification show expenses in excess of income, such excess as recognized by Mortgage Credit, may be carried forward as "unrecovered expense --- prior period."

E. The amount and handling of the required prepayment is subject to the following:

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(11-15) 1. The required prepayment must not exceed the amount that would have been due in cumulative principal payments from the first month after cost certification cut-off through the start of amortization.

2. Prepayment is required only to the extent that the amount of net income permits payment of one or more full monthly principal payments as scheduled. The remaining income is deposited in the reserve for replacement account.

F. If final endorsement has not occurred before the receipt of the supplemental income statement:

1. Analyze the statement.

2. Prepare a letter for the Manager's signature informing the mortgagee of the required prepayment and/or deposit to the reserve for replacement.

3. Mortgagee and mortgagor may elect to cut the mortgage by a sum equal to the mandatory prepayment with any remainder deposited in the reserve for replacements account.

G. If the supplemental income statement is not received before final endorsement, the Director of Housing Development will notify the Director of Housing Management in writing that the statement is required. The Housing Management Division will review the statement, when received, and send the mortgagee a letter concerning the required prepayment and deposit.

H. For projects insured under Section 234, all net income before amortization must be deposited in an escrow account under an agreement approved by the Commissioner.