

CHAPTER 16. INSTRUCTIONS FOR PROCESSING A
MULTIFAMILY INSURED PROJECT
WITH GRANTS/LOANS

16-1. GENERAL. These instructions apply to:

A. Grants and loans to the mortgagor entity from a Federal, State or local government agency or instrumentality.

B. Loans to principals of the mortgagor entity from a Federal, State or local government agency or instrumentality.

C. Grants and loans to the mortgagor entity or its principals from national, regional and local community service organizations (nongovernment source), e.g., Ford Foundation, Rockefeller Foundation, etc.

16-2. APPLICATION FOR MORTGAGE INSURANCE. At the commitment processing stage, the applicant:

A. Identifies the use of grant/loan funds on Form HUD-92013, Application for Project Mortgage Insurance.

B. Submits either:

1. A commitment letter signed by an authorized agent of the government agency or instrumentality or the nongovernment source identifying:

a. Amount of grant/loan funds.

b. Intended use of the grant/loan funds.

c. Any conditions for the loan and reasons, if any, the letter of intent could be withdrawn.

2. For those cases involving a grant/loan from a government/agency or instrumentality, an application showing the information above.

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16-3. SUPPLEMENT TO PROJECT ANALYSIS (FORM HUD-9226-A) is

completed as follows:

A. Criterion 3, Amount Based on:

1. Value (Sections 207, 223(f) profit-motivated, 232 profit-motivated mortgagor, 232 pursuant to 223(f) profit-motivated, 241 and 810(f))

a. Deduct grant/loan funds attributable to mortgageable items from Fair Market Value identified in Section L of Form HUD-92264 or, if a nursing home, Section M of Form HUD-92264(NHICF).

b. Multiply the result by the applicable percentage based on mortgagor type and Section of the Act.

2. Replacement Cost (Sections 202, 213, 221(d), 231, 234, 242)

a. Deduct the amount of grant/loan funds attributable to replacement cost items.

b. Multiply the result by the applicable percentage based on mortgagor type and Section of the Act.

NOTE: Do not deduct that portion of grant/loan attributable to replacement cost items that is more than the HUD estimate. For example, that portion of the land acquisition cost that is in excess of the estimated warranted price of land fully improved would not be deducted.

B. Criterion 6, Amount Based Upon Estimated Cost of Rehabilitation. For those Sections of the Act in which this mortgage criterion is applicable, deduct grant/loan funds attributable to mortgageable items from the sum of the estimated cost of on-site improvements, offsite construction and soft costs reflected on Line 6e. (Not applicable to Section 232 substantial rehabilitation projects involving a nonprofit mortgagor.)

C. For Section 232 nonprofit mortgagors, complete Criterion 10, Amount Based on Deduction of Grants or Gifts, which considers the effect of all grants, gifts and loans.

(16-3) D. For Section 223(f) and Section 232 pursuant to Section 223(f) projects involving a nonprofit mortgagor, complete Criterion 11, Amount Based on Deduction of Grants or Gifts, which considers the effect of all grants, gifts and loans.

E. For Section 223(f) and Section 232 pursuant to Section 223(f) projects, deduct grant/loan funds attributable to mortgageable items from the cost of acquisition or the cost to refinance (Criteria 7 or 10, respectively), whichever is applicable. (Not applicable to a nonprofit mortgagor in a purchase transaction.)

F. A grant/loan:

1. Does not affect other criteria on Form HUD-92264-A.

2. Cannot be used to meet a profit-motivated mortgagor's required investment.

3. Can be used to meet a nonprofit mortgagor's required investment in Sections 223(f), 232 pursuant to Section 223(f) and 232 projects.

G. The lowest mortgage permitted by the applicable criteria becomes the maximum insurable mortgage.

H. Add the grant/loan funds to the mortgage amount in Part A of the "Total Requirements for Settlement" Section of Form HUD-92264-A.

16-4. GRANTS/LOANS FROM GOVERNMENT AGENCY OR INSTRUMENTALITY.

A. Initial Endorsement.

1. Before scheduling the closing, the Legal Division must review the grant/loan documents to assure the legal sufficiency of the documents.

2. The mortgagee must consent in writing to the existence of the second mortgage and agree that its existence does not constitute a basis for default on the first mortgage.

3. The mortgagor may use instead of that portion of the front money escrow provided by the grant/loan, either:

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(16-4) a. An unconditional irrevocable letter of credit issued by a banking institution, or

b. An agreement entered into by HUD, the government agency or instrumentality, the mortgagee and the mortgagor which provides the following:

(1) HUD has:

(a) The right to approve construction advances after considering any reported noncompliance by the agency or instrumentality if the project is proceeding in compliance with approved plans and specifications.

(b) Sole authority to resolve differences in the inspection process and disbursement of grant/loan proceeds.

(2) The mortgagee will concurrently furnish HUD and the agency or instrumentality with copies of Form HUD-92448, Contractor's Requisition, and Form HUD-92403, Application for Insurance of Advances of Mortgage Proceeds.

(3) The agency or instrumentality must process the advance promptly and without adjustment.

(a) Send the agency or instrumentality a copy of the approved requisition for its records.

(b) The agency must notify HUD of a need to make an adjustment the following month.

(4) The agency or instrumentality assumes the risk for any grant/loan funds disbursed in excess of the amount approved by HUD and agrees to replenish the excess funds within 10 working days of notification by HUD.

(16-4) (5) If a default occurs before completion of construction, the agency or instrumentality must disburse the remaining funds so long as the request for funds remains in the same ratio as previously authorized.

(6) The agency's or instrumentality's attorney must render an opinion that the agreement and grant/loan commitment is legally binding on present and all future administrations.

(7) The mortgagor must post either a cash escrow or an unconditional, irrevocable letter of credit equal to no less than 10 percent of the grant/loan proceeds.

(a) The mortgagee must draw upon the escrow if the government agency or instrumentality fails to advance the grant/loan proceeds in a timely manner.

(b) The mortgagor must reinstate any portion of the escrow drawn during the term of the construction loan, within 10 days of the draft for payment.

(c) HUD must establish control of the escrow in a separate agreement.

(d) The escrow may be released at final endorsement.

c. Grant/loan proceeds must be advanced either:

(a) Before mortgage proceeds, or

(b) Concomitantly on a pro rata basis with the disbursement of mortgage proceeds.

NOTE: If the grant/loan proceeds are not available at initial endorsement, HUD may either:

(16-4)* Proceed to initial endorsement, but not disburse any mortgage proceeds until the grant/loan is in place and the funds are available, or

- * Have the mortgagor/sponsor fund an escrow equal to the grant/loan. Advances from this escrow must follow outstanding instructions for the disbursement of the grant/loan.

(c) Release of grant/loan proceeds cannot be geared to the completion of specific improvements.

B. Repayment of the loan may be secured by a second lien on the project provided:

1. Repayment of the second mortgage, including interest, is geared solely to the availability of surplus cash or residual receipts. The following language must be included in the note:

"So long as the Secretary of Housing and Urban Development or his/her successors or assigns, are the insurers or holders of the first mortgage on (insert project name and FHA Project No.), payments due under this note shall be payable only from surplus cash (or residual receipts) of said project, as the term surplus cash (or residual receipts) is defined in the Regulatory Agreement dated (insert date) between HUD and (insert name of mortgagor). The restriction on payment imposed by this paragraph shall not excuse any default caused by the failure of the maker to pay the indebtedness evidenced by this Note."

2. The term of the second mortgage may be extended, if:

a. The note matures, there are no surplus cash funds or residual receipts available for repayment and the first mortgage has not been retired in full.

b. HUD grants a deferment of amortization or forbearance that results in an extended maturity of the insured mortgage.

(16-4) 3. The second mortgage is assumable when a sale or transfer of physical assets occurs provided:

a. Not more than 70 percent of the net proceeds of the sale or transfer is applied to the reduction of the loan.

b. For these instructions, net proceeds are the funds available to the original mortgagor after:

(1) Correcting any monetary or covenant default on the first mortgage.

(2) Making:

(a) Required contributions to any reserve funds.

(b) Needed improvements to the property as evidenced by HUD's annual inspection reports.

4. The loan automatically terminates if HUD acquires title to the project by a deed in lieu of foreclosure.

5. All work performed with the proceeds of the second mortgage:

a. Must be cost certified.

b. Must conform with Davis-Bacon requirements including submission of payrolls, certifications, etc.,

(1) except these requirements are not applicable to 223(f) projects unless the project is to be rehabilitated under 24 CFR 511 or 850 and the cost of repairs, replacements and improvements exceed \$6,500 per dwelling unit as adjusted by any high cost factor.

6. The second mortgage is subject to and subordinate to the first mortgage, the Regulatory Agreement and the Building Loan Agreement.

(16-4) 7. Proceeds of the second mortgage are used to cover only allowable project costs or an anticipated operating shortfall.

8. If a loan is made to the project sponsor, then:

a. The issuer of the loan and the principals must certify that they have no claim and will not later assert any claim against the mortgaged property, the mortgage proceeds, any reserve or deposit made in connection with the mortgage transaction, or against the rents or other income from the mortgaged property for payment of any part of the loan.

b. The mortgagor cannot issue a surplus cash/residual receipts note to the principals as evidence of an obligation of payment for the loan.

9. Besides the conditions cited in items 1 through 8 above, terms of the second mortgage should reflect those provisions found in Forms FRA-1710, -1712 and or -2223, as applicable based on mortgagor type.

16-5. GRANTS/LOANS FROM NONGOVERNMENT SOURCE.

A. Commitment Processing.

1. Financial statements must be submitted which evidence that the providing source has the financial capacity to meet its commitment.

2. The latest 3 years published audited financial statements, if available, must be submitted.

3. If audited financial statements are not available, unaudited statements which meet the requirements of paragraphs 3-2.C and 3-3 must be provided.

B. Initial Endorsement.

1. Before scheduling the closing, the Legal Division reviews the grant/loan documents to assure the legal sufficiency of the documents.

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(16-5) 2. The grant/loan funds must be escrowed with the mortgagee before or at initial endorsement.

3. The grant/loan funds must be disbursed before mortgage proceeds.

4. Release of grant/loan proceeds cannot be geared to the completion of specific improvements.

C. Repayment of a loan:

1. May not be secured by a second lien on the project. (Not applicable for a Section 223(f) or Section 232 pursuant to Section 223(f) project. Refer to paragraph 16-6 below.)

2. Must be evidenced by a surplus cash/residual receipts note provided:

a. Proceeds are used to cover only allowable project costs or an anticipated operating shortfall.

b. The loan is provided to the mortgagor entity.

c. The HUD approved promissory note is not altered in any manner.

3. If the loan is made to the project sponsor or a principal of the sponsor or mortgagor paragraphs 16-4.B.B.a. and b. apply.

D. All work performed with the grant/loan proceeds:

1. Must be cost certified.

2. Must conform with Davis-Bacon requirements including submission of payrolls, certifications, etc. Refer to paragraph 16-4.B.5 for the exceptions to this requirement.

16-6. SECTION 223(f) SECONDARY FINANCING LIMITATIONS. The following secondary financing limitations are applicable to Section 223(f) and Section 232 pursuant to Section 223(f) projects:

A. Purchase transaction. May not exceed the lesser of:

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(16-6) 1. Seven and one-half percent of HUD's estimate of value, or

2. Seven and one-half percent of the cost of acquisition.

B. Refinance transaction. May not exceed the lesser of:

1. Seven and one-half percent of HUD's estimate of value, or

2. Fifty percent of the difference between the cost to refinance and the amount of the maximum mortgage amount reflected on Form HUD-92264-A.

C. Loan from government agency or instrumentality. The Field Office Manager may permit a subordinate lien given in favor of a government agency or instrumentality in an amount up to 15 percent of HUD's Fair Market Value of the project. However, in these cases, no other form of secondary financing may be used.

D. Repayment of the Loan. The requirements in paragraphs 16-4.B and 16-5.C are applicable depending on whether the grant/loan is from a government or nongovernment source. In addition:

1. Form FHA-2223, Promissory Note, must be used without alteration.

2. The terms of the second mortgage shall be approved by the Field Office Counsel and shall be consistent with the terms of the promissory note, the first mortgage and all HUD regulations and requirements. Inasmuch as the second mortgage secures an extremely limited right to payment, language shall be included which expressly sets out these payment rights.

In addition, the second mortgage shall not contain a cross default provision or any right of foreclosure prior to the termination of the HUD mortgage insurance. (Because of these requirements, most standard form mortgages will probably be inappropriate for this type of second mortgage.)

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(16-6) 3. The mortgagee of the HUD insured first mortgage must consent to the placing of any inferior lien.

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