

CHAPTER 8. INSURANCE OF ADVANCES

8-1.CRITERIA FOR ADVANCES.

A. All escrowed funds for on-site improvements (with the possible exception of grant/loan proceeds furnished by a government agency or instrumentality) must be disbursed before mortgage proceeds.

B. The amount of construction funds approved and advanced for insurance must be consistent with construction progress reported by the HUD Field Representative.

C. Other mortgageable items must be supported with proper bills and/or receipts before funds can be approved and advanced for insurance.

D. The amount advanced for construction items must be adjusted for a 10 percent holdback.

E. The final amount approved for insurance must be supported by certified costs recognized in the cost certification review.

8-2.APPLICATION FOR INSURANCE OF ADVANCE OF MORTGAGE PROCEEDS - FORM HUD-92403.

A. Procedure: It is initiated by mortgagor, submitted by mortgagee, reviewed and approved by the Field Office.

B. Frequency: Usually monthly, as stated in the construction contract.

C. The submission must include:

1. Separate entries for architect's fees, carrying charges and financing, and amount due according to Contractor's Requisition - Project Mortgages, Form HUD-92448;

2. Supporting bills/receipts; and

3. Form HUD-92448, if requesting construction funds.

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(8-2) a. Do not process request unless the following items on back of Form HUD-92448 are completed:

(1) Contractor's Prevailing Wage Certificate;

(2) Architect's Certificate; and

(3) Inspector's Certificate.

NOTE: Paragraphs (2) and (3) above are not applicable to the next to final and the final advances. Refer to paragraph B-6.C

b. Contact the Mortgagee and request any missing information.

c. Instructions for processing Form HUD-92448 are contained in Reference 16 of the Foreword.

D. Mortgagee's Role

1. Completes application indicating:

a. Amount requested by mortgagor;

b. Approximate disbursement date;

c. Amount to be advanced from mortgage proceeds;

d. Amount disbursed from mortgagor's front money escrow, if any; and

e. Total loan proceeds disbursed including current request.

2. Submits application to HUD for review and approval.

3. Ensures clear title before advancing the approved disbursement.

4. Notifies HUD in writing when clear title does not exist.

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8-3. APPROVAL AUTHORITY. Applications for advances are routed through the MHR, Cost, Mortgage Credit, then to the Director of Housing Development for signature.

8-4. WAGE AND LABOR VIOLATIONS. Labor Relations staff will notify the Mortgage Credit Branch of wage and labor violations. Do not withhold the funding of requisitions if sufficient funds remain in the holdback to cover the amount of any indicated violation.

8-5. NONPAYMENT DISPUTES. The Director of Housing Development may require that approved disbursements of mortgage proceeds be placed in an escrow if liens against the title evidence that there is slow payment or nonpayment by the mortgagor of project obligations. In order to assure that money drawn down for specified purposes is not diverted to other uses, the mortgagee is required to:

- A. Take control of disbursements, either directly or through an escrow agent.
- B. Supervise the disbursement of the funds to the proper parties.

8-6. STAGES OF ADVANCES. In cases involving insurance of advances, Mortgage Credit analysis is divided into stages:

- A. "Initial Advance" refers to the first application and coincides with the initial endorsement of the credit instrument.
- B. "Interim Advances" refers to subsequent applications up to completion of the project.
- C. "Next to Final Advance" refers to the application for the 10 percent construction holdback upon completion of the construction and review of the general contractor's cost certification. Refer to paragraphs 8-11 and 8-12.
- D. "Final Advance" refers to the application for any remaining balance of mortgage proceeds at final endorsement. This advance takes into consideration funds necessary to set up the escrows for "Items of Delayed Completion and "To Be Paid in Cash Items."

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8-7. PREVIEW OF FIRST APPLICATION. Several days before endorsement, the mortgagor should submit a draft application for the initial advance with supporting documents. Review for acceptability and settle differences that may arise with the mortgagor over possible disallowance. This will lessen confusion at initial endorsement.

8-8. INITIAL/INTERIM ADVANCES. Review the Form HUD-92403 with the Contractor's Requisition and any supporting documents to see whether the amount requested can be approved.

\* A. Approving Initial/Interim Advances:

1. Before advancing any insured mortgage proceeds, disburse other available funding sources in the following order:

a. All funds from the cash escrow established by the mortgagor for onsite construction, fees carrying charges, and financing (front money escrow), unless a pro-rata disbursement arrangement (for tax credit projects only) has been previously approved by the Hub Director.

b. Grant/loan proceeds furnished by a national, regional, or local community service organization or a private source.

c. Grant/loan proceeds furnished by a government agency or instrumentality unless a pro-rata disbursement arrangement has been previously approved by the Hub Director. \*

2. The amount approved for a requested item cannot exceed the amount claimed by the mortgagor.

3. The mortgagee states on Form HUD-92403 the cumulative total of all advances made to the mortgagor, including the advance under consideration. Reconcile any discrepancies before recommending approval of the advance.

4. The HUD approved disbursement amount shall not exceed the sum of the amounts approved:

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a. For mortgage insurance;

a. For funding from the mortgagor's cash escrow; and

b. For funding from available grant/loan proceeds.

\* 5. Pro-Rata Disbursement of Front Money and Mortgage Proceeds on Tax Credit Projects

The mortgagor's front money cash escrow in cases involving low-income housing tax credits (LIHTC) or historic tax credits need not be fully disbursed before the disbursement of the mortgage proceeds.

- a. The mortgagor's front money cash escrow is deposited with the mortgagee in an amount sufficient to meet requirements at initial endorsement under outstanding instructions and so reflected on the Mortgagee's Certificate.
- b. The mortgagee and the HUD field office set up a disbursement schedule based on the ratio of mortgagor's cash escrow and mortgage proceeds to be disbursed. The cash escrow and mortgage proceeds are disbursed concomitantly (on a pro-rata basis).
- c. The pro-rata disbursement must be reflected on the Mortgagee's Certificate and the Building Loan Agreement. Form HUD-92403, Application for Insured Advances of Mortgage Proceeds, is processed in accordance with outstanding instructions, except that it must show the approved funding from both the mortgage proceeds and the mortgagor's cash escrow in proportion to the terms of the pro-rata agreement.
- d. Release of the front money cash escrow, including LIHTC or historic tax credit proceeds, may not be targeted to the completion of specific on-site improvements. \*

B. Architect's Fees. The architect's cash fee is in the Standard Form of Agreement Between Owner and Architect for Housing Services, AIA document B181.

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1. If there is one agreement for both design and for supervisory services, a specific dollar amount must be indicated for each service.
2. There may be separate agreements for design and for supervisory services.
3. The architect's design cash fee may be released with the initial advance.
4. Design services provided by others as detailed in the B181 must be supported by contracts approved by the Field Office during commitment processing before any funds may be advanced.
5. The Mortgagor's and Architect's Certificate, Form HUD-92403.01, must accompany any request or partial request for advance of the design fee.
6. The architect's supervisory cash fee is advanced

based on a percentage of completion method. The maximum amount that may be approved is computed by multiplying the architect's supervisory cash fee by the percentage of work completed and approved on Form HUD-92448, then deducting the total of installments previously paid.

7. There is no "holdback" applied to the disbursements approved from the Architect's Cash Fee.

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

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(8-8) 1. Interest is to be advanced only when and as earned. The mortgagee must specify on Form HUD-92403, the period(s) for which interest is requested and the amount for each period.

a. At initial closing, verify with the mortgagee as to whether a 360 or 365-day (or 366, if leap year) factor is to be used in calculating interest. Check each interest request for accuracy based on the factor indicated by the mortgagee and the annual interest rate approved at initial endorsement.

b. The mortgagee is prohibited from drawing down interest and refunding a portion of the money to the mortgagor. Such practice constitutes a kickback and is not acceptable to HUD and will be treated as a direct mortgage reduction.

2. Taxes. In approving amounts for this line item:

a. Do not allow amounts which accrued before initial endorsement.

b. Approve invoices which are payable during construction, even if a portion of the billing period will be after an allowable cut-off date. Necessary adjustments will be made at the time of cost certification.

3. Insurance. Allow amounts for fire, windstorm, extended coverage, liability and other risk insurance customarily insured against in the community.

a. Follow instructions in Paragraph 8-8.C.2 relative to taxes.

b. Do not approve invoices/receipts for workmen's compensation and/or public liability insurance which are included in the cost estimate.

4. Mortgage Insurance Premium may not exceed the amount due for 1 year.

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(8-8) 5. Initial service charge and permanent lender commitment fees are limited to:

a. The actual amount paid or the amount stipulated in the Mortgagee's Certificate, Form HUD-2434, whichever is less.

b. The initial service fee cannot exceed 2 percent.

c. The combined amount may not exceed 3.5 percent of the mortgage.

NOTE: If the 3.5 percent included in processing exceeds the financing fee charged by the mortgagee, identify the excess as restricted funds. Refer to paragraph 8-8.E.

6. Legal fees may be allowed for:

a. Counsel to create the mortgagor entity; however, do not allow the cost of legal services to create tax shelters, trusts, etc.

b. Costs associated with counsel's review of initial and final closing documents.

c. Normal interim activities in creating a project.

d. Documented costs for items in paragraphs

6.a., b., and c. above which are due and payable before or at initial closing may be approved in the initial advance provided the limitation in paragraph 6.e below is not exceeded.

e. Seventy-five percent may be disbursed at initial closing or during construction. The remaining 25 percent may not be released before final endorsement.

NOTE: Do not allow legal expenses connected with land acquisition, title and recording charges and/or obtaining zoning as they are reflected in the land value.

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(8-8) 7. Organizational fees.

a. The amount included in the replacement cost estimate for organizational fees is an allowance to reimburse the mortgagor for costs incurred to:

- (1) Initiate a project;
- (2) Organize its planning, financing and construction; and
- (3) Control and manage construction through endorsement.

Examples of organizational costs are:

-- Collecting data and documentation for application submissions for mortgage insurance, including analysis of market need, selection and optioning of site and project design considerations.

-- Administrative aspect of assembling the data and documentation from various parties for mortgage closings; arranging for execution of documents; attending closings.

-- Controlling and accounting for disbursement of mortgage proceeds and working capital.

-- Placing mortgagor's hazard and liability insurance, coordinating building release for



occupancy.

-- Liaison with HUD through final endorsement, as normally indicated for typical projects.

b. Release based upon the following:

(1) Disburse 65 percent at initial closing.

(2) Disburse 15 percent during construction based upon a percentage of completion.

(3) Disburse the remaining 20 percent at final endorsement.

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(8-8) c. This allowance may not be used to subordinate the cash requirements for closing.

8. Audit fees associated with obtaining an accountant's opinion of the mortgagor's cost certification cannot be advanced until final endorsement.

9. Title and Recording. Approve amounts typically incurred through initial endorsement, such as:

a. Recording fees;

b. Mortgage and stamp taxes;

c. Survey recording fees;

d. Title insurances; and

e. Title work required for initial endorsement.

NOTE: (1) Do not fully disburse these funds at initial endorsement. Ensure that sufficient funds are maintained in the account to cover title and recording costs required at final endorsement. This may require the approval of an amount less than that requested in the initial draw.

(2) Do not disburse funds for title and recording cost associated with acquisition of the land or property.

10. Consultant's fee, if applicable, is advanced under the guidelines in Handbook 4500.1 REV-1, Allowance for Making Nonprofit Projects Operational (AMPO) and Use of Housing Consultants.

11. Allowance for Making Nonprofit Projects Operational (AMPO), is provided in the replacement cost of certain Sections of the Act involving nonprofit mortgagors. (Refer to Handbook 4500.1 REV-1.)

a. AMPO may be used to:

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(8-8) (1) Defray the cost of equipping and renting the project.

(2) Cover shortfalls in: interest, taxes, property insurance premiums, mortgage insurance premiums, ground rents and assessments during construction when funds under the Building Loan Agreement have been exhausted.

(3) If project income after construction cannot meet the following, set up accruals for these items: real estate taxes, permanent property insurance premiums, mortgage insurance premiums, ground rents and assessments.

b. AMPO cannot be used for:

(1) Construction costs applicable to Total for All Improvements, line 50 of Form HUD-92264, Rental Housing Project Income and Analysis and Appraisal.

(2) Equipment not actually needed for operation of the project.

(3) Leasing or purchasing and maintenance cost of motor vehicles.

(4) Negotiations for and cost of renting any commercial space.

(5) Additional profit or fees to the

architect, attorney, or other  
development team members.

12. Tap fees, soil testing and other fees. Approved disbursement must be fully supported and is not to exceed amount estimated in the general contractor's or mortgagor's list of other fees for requested item(s). Approve disbursement only for items actually due.

13. Contingency reserve. Refer to paragraph 9-1.C.

D. Allocation of Cash Available to the Mortgagor listed on line 42 of Form FHA-2283, Financial Requirements for Closing, (excess mortgage proceeds) may be allocated to the following items:

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(8-8) 1. Cases involving new construction

a. HUD's estimate of the "as-is" value of land or the actual latest arm's length purchase price, whichever is less. The latest arms, length purchase price may include the following costs incurred in connection with the site purchase:

(1) Legal fees associated with negotiations for acquisition of land, zoning, examination of title on the purchase or defense of title after purchase.

(2) Prepaid special assessments.

(3) Interest on bridge loans to purchase property after the date Of submission of the initial application for mortgage insurance.

(4) Taxes.

(5) Cost of improvements made to the project site by the sponsor/mortgagor.

b. Cash escrow to cover offsite construction cost. (Refer to Chapter 7.)

c. Cost of any demolition reflected in the Fair Market Value of Land. Payment is approved as demolition progresses.

d. Construction and/or permanent loan discounts required to be paid at initial closing.

e. Escrow to cover interest shortfall escrow, working capital deposit, initial operating deposit, nonrealty items and any permanent loan discounts not required to be paid at initial closing.

f. Remaining balance may be used to fund any approved change orders or held until final endorsement.

g. When an escrow item is to be funded from excess mortgage proceeds:

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(8-8) (1) Mortgagor must identify in writing the escrow(s) to be established with these funds.

(2) Funds for any discounts not required to be paid at initial closing, must be held until final endorsement.

(3) Paragraphs 18(b), (c) and (d) of Form HUD-2434, Mortgagee's Certificate, must be checked and amended to reflect the amount of any loan discount in escrow.

(4) To avoid the unnecessary accumulation of interest, segregate funds in an unused column(s) on Form HUD-92451.

(5) Requests for release of funds are made on Form HUD-92403 and are subject to the disbursement procedures applicable to the escrow item(s) being requested.

(6) Requests for release of funds for offsite work and construction change orders must include the certifications contained in paragraph 9-1.C.5 and are subject to a 10 percent holdback.

(7) Do not allow mortgagor to draw down funds to establish cash escrow and then substitute a letter of credit to satisfy the escrow requirement.

h. In the event of a mortgage insurance claim before final endorsement, all insurance benefits will be surcharged by:

(1) The remaining cash available to the mortgagor.

(2) The balance of any excess funds which have been earmarked to satisfy escrow requirements.

(3) The full amount of excess mortgage proceeds that were used to fund permanent loan discounts required to be paid at initial endorsement, except for

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(8-8) those cases where the construction and permanent loan funding source are the same.

2. Cases involving rehabilitation of existing construction

a. HUD's estimate of the "as is" value by market comparison or the mortgagor's acquisition cost/existing indebtedness, whichever is less.

b. Items 1b through h as set forth under New Construction.

E. Restricted Excess Mortgage Proceeds are those excess mortgage proceeds determined not to be available to the mortgagor during construction, i.e., difference by which the HUD estimate exceeds contract amounts.

1. These funds cannot be used to satisfy any escrow requirements and must be held until final endorsement.

2. Identify these funds in an unused column of Form HUD-92451 as restricted funds.

F. Certificate of Mortgage Insurance. Prepare when the advance is eligible for approval.

1. The approved sum is the total for the Contractor's Requisition and other eligible line

items.

2. The total approved for any item must not exceed the amount allocated to the item unless the mortgagee submits a written request for permission to reallocate funds between line items. Any such request must:

a. Provide documentation to support expenses in excess of the allocated amount.

b. Provide for a corresponding reduction in the amount of another line item with supporting documentation which evidences that the funds identified will not be needed for future expenses for the line item during construction.

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(8-8) c. Be approved in writing by the Director of Housing Development.

3. The sum approved for mortgage insurance is the amount approved for advance less any funds remaining in the front money escrow and any grant/loan proceeds.

8-9. PROGRESS SCHEDULE. Before initial endorsement, the mortgagor gives the Architectural, Engineering and Cost (A, E & C) Branch a copy of the "Estimated Progress Schedule for Work" for review and approval.

A. The schedule shows an estimated construction completion percentage for each month of the construction period.

B. The schedule is revised, subject to approval of mortgagor's architect and the Field Office, if the conditions of work change, i.e., change orders for extensions of time.

C. The A, E & C Branch gives a copy of the progress schedule and subsequent updates to the Mortgage Credit Branch for use in processing Form HUD-92403.

D. Each month determine whether construction progress is in line with loan advances. If the loan is out of balance and construction is not progressing according to the contractor's progress schedule:

1. Advise the Director of Housing Development and

prepare a letter (obtain concurrence of Chief of A, E & C Branch) for the Director's signature to the mortgagee.

a. Inform the mortgagee of the apparent lack of construction progress and impending lack of mortgage proceeds.

b. Request meeting of all interested parties, including but not limited to, the mortgagor, supervisory architect, general contractor, mortgagee, surety and various legal counsel to discuss:

(1) Problems associated with the construction.

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(8-9) (2) Remedies and the consequences.

2. Send a copy of the letter to the surety and other interested parties.

8-10. KEEPING THE MORTGAGE IN BALANCE. The liquidated/actual damages clause in the construction contract is not intended to penalize the contractor, but to provide a source of funds for overruns in interest, taxes, MIP and insurance when such overruns are a result of delays experienced before completion of the project and which are the fault of the general contractor, i.e., poor performance.

A. When the interest allocation is near exhaustion, ask the architect and the HUD inspector to estimate an expected completion date.

1. Compute the minimum liquidated damages for the period between the completion date specified in the construction contract, as adjusted by approved change orders, and the assumed completion date.

2. When the interest allocation has been exhausted, AMPO or the working capital escrow should be used to keep interest current.

3. Transfer the computed liquidated damages amount from Column I, Construction, to Column G, Carrying Charges and Financing, on Form HUD-92451.

a. Allocate full amount to interest, initially.

b. Funds may be used for MIP, taxes or insurance payments, if requested, after the funds for these line items and AMPO or the working capital escrow are exhausted. However, funds transferred from the construction account may be used to cover only the cost of these items attributable to the period in paragraph 1 above.

B. Notify the mortgagor, contractor, mortgagee and surety, if any, by certified mail of the amount and the reason for the transfer.

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(8-10) C. Require written acknowledgement from the mortgagee and surety, if any, before transferring funds.

D. The amount of transferred funds must be reflected on subsequent Forms HUD-92448 as a decrease to item 7, Sum of Cost Breakdown Items Plus Inventories of Materials.

E. After review of the cost certification documents, if the full amount of transferred funds was not needed to cover the cost of interest, MIP, taxes, and insurance attributable to the period identified in paragraph 1 above, transfer the balance back to the construction account.

F. In processing Form HUD-92448 releasing the general contractor's holdback, make adjustment for the lesser of actual or liquidated damages determined in the cost certification review.

G. This procedure only should be invoked only if the Director of Housing Development determines that the problems causing the delay will be remedied within the near future.

8-11. NEXT TO FINAL ADVANCE is requested when construction is acceptably complete, even though there may be items of delayed completion.

A. It may provide for the release of the contractor's holdback provided the conditions in paragraph 8-12 have been met. The amount approved for release is the unpaid balance of the holdback less escrows for:



1. Items of delayed completion;
2. Liquidated/actual damages; and/or
3. The net effect of negative change orders.

B. The balance of the offsite escrow may be released provided:

1. All offsite sewer, water, electrical and gas facilities are completely installed and connected; and safe, and adequate all weather facilities for ingress and egress are provided.

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- (8-11)            2. All other required offsite construction, if any, is completed.

3. Otherwise, completion is to be assured by a cash deposit in an amount equal to 150 percent of the HUD estimate of the cost of such offsite construction.

8-12.\*REQUESTS TO REDUCE AND/OR RELEASE THE CONTRACTOR'S HOLDBACK OF MORTGAGE PROCEEDS. Release funds following instructions in Reference 8 of the Foreword. \*

8-13.FINAL ADVANCE. The Application for Insurance of the Final Advance requests any remaining balance of mortgage proceeds. Ensure that:

A.The mortgagor's cost certification has been approved and the maximum insurable mortgage amount redetermined using Form FHA-2580, Maximum Insurable Mortgage. (Refer to paragraphs 11-10, 11-11 and 11-12.)

B.The Form HUD-92403 is accompanied by a completed Form HUD-92448, with required Contractor's Prevailing Wage Certificate, if the contractor's holdback has not been previously disbursed. Refer to paragraph 8-12 for instructions on releasing the contractor's holdback.

C.The sum to be approved for advance is the balance of the mortgage proceeds, based on the maximum insurable mortgage on Form FHA-2580. Refer to paragraph 11-15 for instructions relative to advance amortization adjustment, if any.

D.Set up the escrow under the provisions of Form HUD-2456,

Escrow Deposit Agreement, for items of delayed completion as required by Form HUD-92403.

E. Form FHA-2023, Request for Final Endorsement of Credit Instrument, or FHA-2455 (For Insurance Upon Completion Projects Only) have been submitted and reviewed in accordance with paragraph 11-14.

F. Set up the escrow for the mortgagor's unpaid construction costs under the provisions of Form HUD-92476.1, Escrow Agreement for Unpaid Construction Costs, Repairs or Needs Assessment Repairs. Refer to paragraph 11-14.