

---

CHAPTER 3. INITIAL ENDORSEMENT

- 3-1. INITIAL ENDORSEMENT INVESTOR SPONSOR MORTGAGOR. The characteristics of this type loan are discussed in Chapter 1 of this Handbook. The purpose of the Investor-Sponsor program is to permit an investor-sponsor to proceed with construction before the proposed management type cooperative has been organized, certifying that it is his intention to sell the project to a cooperative within a period of two years after completion. It is to be noted that the procedure in Section 221(d)(3) Investor-Sponsor projects differs from that under Section 213. In Section 213, three insurance endorsements are contemplated - initial endorsement of the Investor-Sponsor loan, final endorsement of the Investor-Sponsor loan and a single endorsement of the mortgage loan obtained by the purchasing management type cooperative. Under Section 221(d)(3), a third insurance endorsement is not involved. The appropriate closing check list to be used for initial endorsement of the Investor-Sponsor loan under both Section 213 and 221(d)(3) is FHA Form 3257.
- 3-2. COOPERATIVE REPRESENTATION AT THE CLOSING. A member of the Provisional Board of Directors of the proposed purchasing cooperative corporation should be present at the closing.
- 3-3. ASSURANCE OF PERMANENT FINANCING. An additional administrative closing requirement in Investor-Sponsor cases is that there must be submitted written assurance of permanent financing covering the anticipated purchase of the completed project by a purchasing management type cooperative. The adequacy of the assurance is a matter for the determination of the Field Office Director.
- 3-4. MORTGAGE (OR DEED OF TRUST) INVESTOR-SPONSOR PROJECTS. In Section 213 Investor-Sponsor cases, the following covenant will be added to the mortgage in an appropriate place:

"...and the mortgagor further covenants with the mortgagee as follows: That the mortgagor during the period between initial endorsement and final endorsement for mortgage insurance by the Assistant Secretary-FHA Commissioner and until either 2 years after the date of the completion of the housing project or acquisition of the mortgaged property by a nonprofit

---

ownership housing corporation or trust, shall deposit monthly with the mortgagee all net receipts as defined in the Articles of Incorporation/Regulatory Agreement of the mortgagor."

"That if at the end of 2 years after the date of its completion the mortgaged property has not been sold to a nonprofit housing ownership corporation or trust, the mortgagee shall apply the total amount of such net receipts as a partial repayment of principal and such payment shall be deemed to be made pursuant to a requirement of the Assistant Secretary-FHA Commissioner."

"That in case title to the mortgaged property is conveyed to a nonprofit ownership housing corporation or trust, the accumulation of the monthly net receipts shall be credited to such purchasing nonprofit ownership housing corporation or trust."

3-5. TITLE. In Section 213 Investor-Sponsor cases arrangements should be made at the initial closing of the investor's loan for the issuance of title coverage which will be required in connection with the closing of the cooperative loan. It should be noted in this connection that the cooperative loan will normally be higher in amount than the Investor-Sponsor loan.

3-6. PREPAYMENT. FHA Form 3010-3 describes how the amortization figures are computed. If the mortgage note in Section 221(d)(3) and 213 Investor-Sponsor cases contains a provision for additional charges in the event aggregate payments in any one calendar year exceed 15% of the original face amount of the mortgage, then the following language should be added:

"And provided further that (1) no additional charge shall be collected by the Obligee if the debt is paid in whole by reason of the mortgaged property being sold, within two(2) years after the date of its completion to a nonprofit ownership housing corporation or trust and, (2) no additional charge shall be collected by the Obligee for any partial prepayment of principal which is made by the Obligor or on its behalf pursuant to a requirement of the Assistant Secretary-FHA Commissioner."

- 
- 3-7. ON-SITE CONSTRUCTION CONTRACT. HUD prescribes two forms of Construction Contract for use in multifamily programs: Construction Contract--Lump Sum (FHA Form No. 2442) and Construction Contract--Cost-Plus (FHA Form No. 2442-A).
- a. Generally, where no identity of interest between the mortgagor and the builder exists, a "lump sum" contract may be used at the discretion of the mortgagor. If the Director determines that an identity of interest exists between the mortgagor and the builder, the "cost-plus" form of contract must be used.
  - b. In Consumer-Initiated Projects, or those sponsored by labor, religious, fraternal, Veteran or other organizations independent of the builder established for the purpose of representing the cooperative, a lump sum or cost-plus contract may be used at the discretion of the contracting parties.
  - c. A Cost-Plus Fixed Fee Contract with an Upset Price as hereinafter described shall be used in any case under the following circumstances:
    - (1) When one or more of the officers or directors of the mortgagor is also an officer, director or stockholder of the general contractor.
    - (2) When any officer or director of the mortgagor has any financial interest whatsoever in the general contractor.
    - (3) When the builder or his associates, either directly or indirectly, form the mortgagor corporation and/or select its officers or directors.
    - (4) When the proposed contract amount exceeds the HUD-FHA estimate for the work as shown on the Project Income Analysis and Appraisal, FHA Form 2264. (This provision may be waived in the discretion of the Director upon request of the mortgagor corporation in cases where the Director has determined that no identity of interest exists).
  - d. A copy of the Contractor's and/or Mortgagor's Cost Breakdown (FHA Form 2338) must be attached as an exhibit to the contract. The total for all improvements shown on the cost breakdown must equal the amount to be paid to the contractor pursuant to Article 3 of the lump sum contract or the upset price set out in Article 3 of the cost-plus contract.
-

- (3-7) e. The Time for Completion to be set forth in the construction contract should be at least one month earlier than the completion date set forth in the Building Loan Agreement. The contract time normally should not exceed the number of months on which the computation of interest is based for purposes of estimating replacement cost in Form 2264. However, in cases involving an early start of construction the time may vary according to the nature of the early start. For example, the builder may intend only to construct model units prior to initial closing. After completion of the units it may take several months to achieve a sufficient number of sales to close the loan. During those several months no work may have been done. Although the commitment may have contemplated a 12-month construction period, the actual time required to complete the project (i.e., the time from early start approval to project completion) may be several months longer. Therefore, instead of a completion date certain in Article 2, the contract may provide for completion no later than the first day of the second month next preceding the date prescribed by HUD for commencement of amortization of the cooperative's mortgage loan. In other words, HUD may determine at the time of initial closing that six months' work remains to be done. With a two-month "rent-up", amortization would begin the first day of the ninth month from the month in which the closing is scheduled, completion under the Building Loan Agreement would be required by the first day of the eighth month and completion under the construction contract by the first day of the seventh month.
- f. Liquidated Damages. Both FHA forms of construction contract provide for liquidated damages in the event the contractor does not complete on time. This provision may be deleted in any case where the contractor has undertaken, by another agreement incorporated in the construction contract giving broader benefits by indemnifying the cooperative against cost overruns.
- g. Construction Changes. The FHA contract forms also provide for construction changes equal to two percent (plus or minus) of the contract amount without HUD approval. In management type cooperative cases, this provision should be modified to require HUD approval of any proposed construction changes.

---

3-8. FORM OF CONTRACT - INVESTOR-SPONSOR CASES. If the Field Office Director determines that an identity of interest exists pursuant to the basic rental housing instructions (Reference (4) of the Foreword), the "cost-plus" form of contract (FHA Form 2442-A) must be used. If no identity of interest is indicated, the contract may be either "lump-sum" (FHA Form 2442) or "cost-plus" (FHA Form 2442-A).

3-9. MODIFICATIONS TO CONSTRUCTION CONTRACT FHA FORMS 2442 and 2442-A.

- a. The last sentence of Article 10 in each of the contract forms shall be modified to read as follows:

The Contractor hereby agrees that the owner may assign this Contract or any rights arising thereunder, including any guaranties or warranties of workmanship or materials to the Lender or the Secretary or to a purchasing nonprofit cooperative housing corporation.

- b. Since it is the purpose of the investor-sponsor to sell the project to a management type cooperative within 2 years of the date of completion at certified cost, the interest of the consumer is served by providing the builder with an incentive to effect savings in construction costs. It is, however, recognized that provision must be made so that the benefits of any incentive provision will inure to the purchasing cooperative. Therefore, in cases where the upset sum does not exceed the HUD-FHA construction estimate Article III of the FHA Form 2442-A may be amended if desired by the parties by substituting for the first paragraph thereof the following:

The Owner shall pay to the Contractor for the performance of the Contract, subject to additions and deductions provided herein on account of construction, the actual cost of construction, as hereinafter defined, plus a fee equal to \_\_\_\_\_ but in no event shall the contract price, including the fee, exceed \_\_\_\_\_ Dollars. The fee specified in the preceding sentence shall be increased by \_\_\_\_\_ percent of the amount by which the upset sum set forth above, less the specified cash fee, exceeds the actual cost of construction; provided, however, that the

(3-9)

parties hereto agree that the entire amount by which the cash fee is so increased shall be transferred by the lender into an escrow agreement, in form and substance satisfactory to HUD-FHA, which shall provide as follows:

- (1) The aforesaid escrow funds shall be payable to the Contractor in the event that the project is sold to a purchasing cooperative approved by HUD-FHA within 2 years from the date of the completion of the project.
- (2) In the event such sale to a cooperative approved by HUD-FHA is not consummated within 2 years from the date of completion of the project or if at any time prior to the expiration of such 2-year period, the Owner-Investor-Sponsor Corporation is in default under the terms of the mortgage or the provisions of its articles of incorporation/regulatory agreement, the aforesaid escrow funds shall be disbursed and payable only for such purposes as HUD-FHA shall direct, and shall in no event be payable to the Contractor.
- (3) If, upon completion, the total of the actual cost of construction plus the allowable fee as computed above shall be less than \_\_\_\_\_, the contract price shall be reduced to the said total amount of actual construction cost and allowed fee; and if the Contractor shall have received payment of any amounts in excess of the actual cost of construction plus the allowed fee, all such excess shall be refunded to the Owner on demand.

- (4) The figure in the first blank space will

be the cash fee agreed upon between the mortgagor and general contractor but not in excess of the amount shown for builder's fee on the Project Analysis, FHA Form 2264. The total of the payment breakdown attached to the construction contract should equal the upset price, including the cash fee. The upset figure is to be inserted in the second as well as last blank spaces.

- (5) The percentage figure to be inserted shall be the figure desired by the contracting parties but may not exceed 50%.

- 3-10. ATTORNEY'S CERTIFICATION. In Investor-Sponsor cases, the certifications required in the attorney's opinion are the same as in a rental housing project, except that prior to solicitation for memberships in the cooperative corporation, an attorney must be retained to represent the cooperative corporation.
- 3-11. MORTGAGEE'S CERTIFICATE, FHA FORM 3220.
- a. In Investor-Sponsor Cases, the amount to be inserted for the legal and organizational expenses of the cooperative purchaser is specified in the commitment for insurance.
- b. The Amount of Financing Discount is not controlled by HUD-FHA, except that the Director may refuse to acquiesce in a discount which he determines affects project feasibility. Initial endorsement constitutes approval of the amount set forth in the mortgagee's certificate.
- 3-12. MORTGAGOR'S CERTIFICATE, FHA FORM 3212-A. In Investor-Sponsor cases under both Sections 213 and 221(d)-(3)) the appropriate Form is Mortgagor's Certificate, FHA Form 3212-A.
- 3-13. MANAGEMENT AGREEMENTS. Insofar as Investor-Sponsor projects are concerned, during the period prior to transfer of title to the cooperative, there is no prescribed form of management agreement and rental housing procedures in this regard should be followed.

- 
- 3-14. STATEMENT COVERING LEGAL AND ORGANIZATIONAL EXPENSE.
- a. In Investor-Sponsor Cases, the statement will indicate that all legal and organizational expenses of the Investor-Sponsor corporation have been paid or will be paid out of the initial

advance by the mortgagee for this purpose. The amount to be escrowed for the legal and organizational expenses of the cooperative is discussed in this Handbook under the heading "Mortgagee's Certificate."

- b. Legal and Organizational Expenses. It should be borne in mind that two legal and organizational expenses are involved and should be reflected in FHA Form 2330, namely the expenses involving the mortgagor (Investor-Sponsor) and those involving the cooperative corporation formed to purchase the project. The Investor-Sponsor, in addition to constructing the project, has the statutory obligation to use his best efforts to sell the project to a cooperative and his expenses in doing so are therefore properly includable. If before final endorsement the legal and organizational sum attributable to the cooperative has been exhausted by HUD-FHA-approved draws against same, the Investor-Sponsor may deposit additional sums with the mortgagee prior to final endorsement for application against further organizational expenses of the cooperative (as approved by the FHA) and to the extent that such additional sums are used for this purpose with HUD-FHA approval they may be included in cost certification. (See cost certification instructions relating to adjustments for undetermined costs).
- c. If the Investor-Sponsor is Involved in the Selling Effort, neither he nor any entity with which he is connected should be permitted a fee for such services, but he may properly be reimbursed for out-of-pocket expenses.
- d. Bonding. The parties should be specifically advised that regardless of the type of sales agent, both the agent and employees thereof who are responsible for handling down payment monies should be covered by an adequate fidelity bond, satisfactory to the cooperative's attorney, protecting the subscriber's deposits.
- e. It is the Responsibility of the Field Office to determine the acceptability of the sales agent in each case at the time the acceptability of the sponsorship is being determined.

---

3-15. DISBURSEMENT OF LEGAL, ORGANIZATION EXPENSE RELATING TO SERVICES RENDERED TO THE INVESTOR-SPONSOR MORTGAGOR ENTITY.

- a. Investor-Sponsor Mortgagor. The amount of legal and organizational expense allowance for the investor-sponsor mortgagor entity will have been separately computed in



accordance with the instructions for FHA Form 2264, set forth in Reference (12) of the Foreword. The recommended disbursement is as follows:

Initial Closing	Final Closing
Legal.....75%	Legal.....25%
Organization.....85%	Organization.....15%

- b. Cooperative Mortgagor. The amount of the legal, organization and marketing expense allowance for the cooperative mortgagor will have been separately computed in accordance with the instructions for FHA Form 2264-B set forth in Reference (12) of the Foreword. The recommended disbursement is as follows:

Establishment of Purchasing Cooperative and Approval of Organization and Sales Documents	Title Transfer to Purchasing Cooperative
Legal.....75%	Legal.....25%
Organization.....85%	Organization.....15%
Marketing.....30% + * %	Marketing.....balance**

\*The basic 30% represents completion of the sales literature and organization of the sales office. The balance of the allowance should be paid in accordance with the percentage of sales completed. No development service allowance is permitted in investor-sponsor cases. However, the Legal and Organization allowance will be larger to allow for payment of the legal and organization fees of both a rental mortgagor entity and a cooperative mortgagor entity. The balance of all cooperative allowances will be drawn from mortgage proceeds but will be retained by the mortgagee under a suitable escrow agreement until disbursed. Reference is made to the preceding paragraph 3-14.c. of this Handbook if the investor-sponsor is involved in the sales effort.

\*\*If 100% of sales have not been made a proportionate amount of the allowance must continue to be held.

---

3-16. CORPORATE DOCUMENTS OF INVESTOR-SPONSOR MORTGAGOR.

- a. The Forms of Certificate of Incorporation and By-Laws of the Investor-Sponsor corporation to be obtained at closing are displayed in the forms appendix to this Handbook. In addition, stock subscription agreements must be submitted in a form

satisfactory to the Regional Attorney. Otherwise, the instructions set forth relative to Management and Sales Type cases are applicable. (See References (2) and (5) of the Foreword.)

- b. The Organizational Documents applicable to the cooperative purchasing corporation are not usually submitted to HUD-FHA for approval until after the Investor-Sponsor loan has been initially endorsed.

3-17. PAYMENT OF HUD-FHA FEES. The following HUD-FHA fees are applicable:

- a. First Mortgage Insurance Premium, 1/2 of 1% of face amount of mortgage. This should be paid in the form of a Cashier's or Certified Check of the mortgagee payable to the order of HUD-FHA. (Not required in Section 221(d)(3) below market interest rate cases.)
- b. Project Inspection Fee, 1/2 of 1% of commitment amount per Project Fiscal Procedures. (See Reference (6) of the Foreword.) This should be paid in the same manner indicated under paragraph 3-17.a., above. In Existing Construction cases, the fee is based on the amount allocated to demolition and new work.
- c. Commitment Fee. The Field Office should recheck to ascertain that the commitment fee has been paid in the requisite amount.
- d. For more Detailed Information as to the manner in which these fees are computed, reference should be made to Reference (6) of the Foreword.

3-18. CASH REQUIRED FOR COMPLETION OF PROJECT. A deposit must be made with the mortgagee (to be reflected in paragraph (5) of Mortgagee's Certificate, FHA Form 3220) of the amount required to complete the project over and above the sums to be disbursed from the mortgage. These funds will be advanced by the mortgagee prior to disbursement and insurance of any of the mortgage proceeds. The amount of the deposit is obtained from the Financial Requirements for Closing.

---

3-19. ASSURANCE OF COMPLETION OF ON-SITE FACILITIES. Assurance of completion is by bond or escrow deposit. Acceptable bonds are (a) standard American Institute of Architects form of construction bond; or (b) "Contract Bond-Dual Obligee," FHA Form 2452, (Rev. May, 1947). Copies of the American Institute of Architects bond may be obtained at stationery stores or directly from the American Institute of Architects, 1741 New York Avenue, N. W., Washington,

D. C. Any surety on the accredited list of the U. S. Treasury is acceptable. The acceptance of the surety and the amount of the bond are the responsibilities of the Field Office Director. The legal sufficiency and form of the bond are the responsibility of the HUD Area Counsel. (For types of assurances see Reference (2) of the Foreword.)