

CHAPTER 5. INSTRUCTIONS FOR PROCESSING AN INSURED SRO  
PROJECT WITH GRANTS/LOAN.

- 5-1. GENERAL. These instructions apply to:
- A. Loans to principals of the mortgagor entity from a Federal, State or local government agency or instrumentality.
  - B. Grants and Loans to the mortgagor entity from a Federal, State or local government agency or instrumentality.
- 5-2. 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 "letter of intent" signed by an authorized agent of the government agency or instrumentality showing: .
      - a. Amount of the grant/loan funds.
      - b. Intended use of the grant/loan funds.
      - c. original source of grant monies, if not submitted presume Federal funds are involved.
    - 2. An application for the grant/loan showing the information above.
- 5-3. REPLACEMENT COST FORMULA. Forms HUD-92013 and 92264 must reflect the inclusion of all proposed mortgageable improvements whether they are to be funded by the grant/loan funds or mortgage proceeds. The Valuation Branch:
- A. Deducts the amount of the grant/loan funds attributed to replacement cost (mortgageable) items when computing the mortgage amount based on the replacement cost by formula.

- (5-3) NOTE: Don't deduct that portion of a grant attributable to a replacement cost item 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.

- B. Don't deduct grant/loan funds earmarked for nonreplacement cost (i.e., not mortgageable) items.
- C. Completes either:
  - 1. Appendix 1 for proposed construction projects
  - 2. Appendix 2 for rehabilitation projects
- D. Prepares a trial copy of Form HUD-92264-A, following outstanding mortgage credit instructions as modified by paragraph 5-4 below.
- E. Completes the Total Estimated Replacement Cost of Project in Section G of Form HUD-92264 using the maximum insurable mortgage developed on the trial Form HUD-92264-A.

5-4. SUPPLEMENT TO PROJECT ANALYSIS (FORM HUD-92264-A) is completed as follows:

- A. Criterion 3, Value/Replacement Cost
  - 1. Deduct grant/loan funds attributed to mortgageable items from the total of the replacement cost taken from Section G, line 74 of Form HUD-92264, Project Income and Analysis.
  - 2. Multiply the result by the applicable percentage:

:Section	: Mortgagor	:Percentage:
:1) 221(d) (3)	: General and Limited Distribution	: 90 :
:2) 221(d) (3)	: Nonprofit	: 100 :
:3) 221(d) (4)	: All Mortgagors	: 90 :

- B. A grant/loan:
  - 1. Does not affect other criteria on Form HUD-92264A.
  - 2. Cannot be used to meet the mortgagor's required investment.

(5-4)

- C. The lowest mortgage permitted by the applicable criteria becomes the maximum insurable mortgage.
- D. Add the grant/loan funds to the mortgage amount in Part

A of the "Total Requirement for Settlement" section of Form HUD-92264-A.

5-5. INITIAL ENDORSEMENT.

- A. Field Office Counsel reviews the grant/loan documents to assure legal sufficiency of the documents.
- B. The mortgagee must consent to the existence of the second mortgage and agree that its existence doesn't constitute a basis for default on the first mortgage.
- C. The mortgagor may use instead of that portion of the front money escrow provided by the grant/loan, either:
  - 1. An unconditional irrevocable letter of credit issued by a banking institution or
  - 2. An agreement entered into by HUD, the government agency or instrumentality, the mortgagee and the mortgagor that provides the following:
    - a. HUD has:
      - (1) 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.
      - (2) Sole authority to resolve differences in the inspection process and disbursement of grant/loan proceeds.
    - b. The mortgagee will concurrently supply 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.

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- (5-5) c. The agency or instrumentality must process the advance promptly and without adjustment.
  - (1) Send the agency or instrumentality a copy of the approved requisition for their records.
  - (2) The agency must notify HUD of a need to make an adjustment the following month.
- d. If 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.

- e. The agency or instrumentality attorney must render an opinion that the agreement and grant/loan commitment is legally binding on the present and all future administrations.
- f. 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.
  - (1) The mortgagee must draw upon the escrow if the government agency or instrumentality fails to advance the grant/loan proceeds in a timely manner.
  - (2) The mortgagor must reinstate any portion of the escrow called during the term of the construction loan, within 10 days of the draft for payment.
  - (3) HUD must establish control of the escrow in a separate agreement.

D. Grant/loan proceeds may be advanced:

- 1. Before mortgage proceeds or
- 2. Concomitantly on a prorata basis with the disbursement of mortgage proceeds.

- (5-5)           NOTE:    If the grant/loan proceeds are not available at initial endorsement, HUD may either:
- \*    Go 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 a front money escrow equal to the grant/loan. Advances from this escrow must follow outstanding instructions for the disbursement of the grant/loan.

- 3. Release of grant/loan Proceeds cannot be geared to

the completion of specific improvements.

5-6. REPAYMENT OF THE LOAN may be secured by a second lien on the project provided:

- A. Repayment of the secondary 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."

- B. The term of the second mortgage may be extended, if:
1. 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.
  2. HUD grants a deferment of amortization or forbearance that results in an extended maturity of the insured mortgage.

(5-6)

- C. The second mortgage is assumable when a sale or transfer of physical assets occurs provided:
1. Not more than 70 percent of the net proceeds of the sale or transfer is applied to the reduction of the loan.
  2. For these instructions, net proceeds are the funds available to the original mortgagor after:
    - a. Correcting any monetary or covenant default on the first mortgage.
    - b. Making:
      - (1) Necessary contributions to any required reserve funds.

- (2) Needed improvements to the property as evidenced by HUD's annual inspections reports.
- D. The loan automatically terminates if HUD acquires title to the project by a deed in lieu of foreclosure.
- E. All work performed with the proceeds of the second mortgage:
  - 1. Will be cost certified.
  - 2. Will conform with Davis-Bacon requirements including the submission of payrolls, certifications, etc.
- F. The second mortgage is subject to and subordinate to the first mortgage, the Regulatory Agreement and the Building Loan Agreement.
- G. Proceeds of the second mortgage are used to cover only project related items.
- H. If a loan is made to the project sponsor then:
  - 1. 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

- (5-6) 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.
- 2. The mortgagor cannot issue a surplus cash/residual receipts note to the principals as evidence of an obligation of payment for the loan.
- I. Besides the conditions cited in items, A through H above, terms of the second mortgage should reflect those provisions found in Forms FHA 1710, 1712 or 2223, as applicable based on mortgagor type.