CHAPTER 12. INITIAL CLOSING - COINSURED CONSTRUCTION ADVANCES

12-1. PREPARATION FOR INITIAL CLOSING. Required for coinsurance of advances cases only. (See Chapter 15 for coinsurance on completion requirements.)

A. Firm commitment conditions. The lender must ensure that the mortgagor complies with all conditions of the firm commitment.

B. Closing site. Any place agreed to by lender and mortgagor except a HUD field office.

C. Initial advance of mortgage proceeds. The first coinsured advance is usually made at initial closing to cover costs incurred before construction or otherwise due and payable, such as land acquisition, design architect fees, initial service charge, MIP, etc. (See Chapter 10).

NOTE: No construction of any kind may begin before initial closing and recording of the mortgage (except in the limited case described in paragraph 12-7).

12-2. PRE-CONSTRUCTION CONFERENCE. Required for every project; usually held at initial closing. It may be earlier or later but must precede actual construction start. (See paragraph 13-7, Chapter 7, and Handbook 1344.1 Federal Labor Standards Compliance in Housing and Community Development Programs, for labor standards requirements during construction.)

A. Who must attend

- Representative(s) of mortgagor
- General contractor
- Major subcontractors
- Lender's construction inspector
- Lender's labor standards specialist

NOTE: You must keep an attendance list for each pre-construction conference for the permanent project file.

B. The lender must:

1) Outline HUD's contract requirements on: labor standards; prevailing wage procedures; and equal employment.
(12-2) 2) Explain Form HUD-2554, Supplementary Conditions of the Contract for Construction, including:

   a) Contractual obligations of general contractor or subcontractors.

   b) Statement of sanctions imposed for non-compliance with supplemental conditions.

3) Requirement that the HUD-2554 be part of all contracts with a subcontractor.

3) Give copies of the Equal Opportunity poster to the general contractor and each subcontractor for posting in conspicuous places on the construction site.

4) Give extra copies of the HUD-2554 to the general contractor for any absent subcontractors.

5) See that a current wage determination is delivered to the general contractor and subcontractors and emphasize importance of prevailing wage payments, prompt payroll submissions, and record keeping.

6) Indicate lender staff who will review for labor standards compliance.

7) Explain cost certification requirements for mortgagor, general contractors and, if applicable, subcontractors.

12-3. REVISION OF FORMS.

   A. The HUD and FHA forms and formats listed in Appendix 1 must be used as follows:

      1. Required. You must use required forms and formats with no changes, unless HUD Headquarters approves changes in writing. You may print them on your letterhead.

      2. Equivalent. You may revise equivalent forms and formats or devise your own equivalent subject to prior HUD Headquarters written approval. Until HUD approval, you must use the required forms and formats.

   B. Closing documents. The rules of paragraph A, above, apply. You may submit a complete package of your proposed closing documents with any modifications directly to HUD Headquarters, Office of General Counsel, Office of Insured Housing and Finance (Multifamily Mortgage Insurance) for review.
12-4. USE OF LETTERS OF CREDIT.

A. You may accept letters of credit instead of cash to set up many of the escrows required at initial and final endorsement or during construction. When a letter of credit is permitted by this handbook, it must always be:

1. Unconditional and irrevocable
2. Issued by a banking institution
3. Valid and collectible

B. You, as lender of record, may not be the issuer of any letter of credit without prior written consent of HUD Headquarters.

C. If a demand under any letter of credit is not met immediately, you must provide the cash equivalent to the undrawn balance under the letter of credit.

12-5. INITIAL CLOSING DOCUMENTS. The forms and documents listed below are self-explanatory except as noted in the paragraphs that follow the list. Required forms are starred (*). At closing, the lender must collect an original for its files or a completely legible copy (certified true and correct) if the original is unavailable because of filing or recording requirements.

- Mortgagor's organizational documents
- Lease (if there is a leasehold - see Form PHA-2070 for required lease provisions) (Appendix 66)
- Survey
- * Surveyor's Certificate (FHA-2457) (Appendix 13)
- Evidence of zoning compliance
- Building permits
- * Mortgage (Deed of Trust)
- * Note
- * Coinsurance Regulatory Agreement (Appendix 36)
- * Building Loan Agreement (Appendix 32)
- * Mortgagor's Certificate (Appendix 34) and Mortgagor's Attorney's Opinion
- * Mortgagor's Oath (Appendix 35)
- Title Policy
- Hazard insurance policy
- * Construction contract (Appendix 26)
- * Owner-Architect Agreement (Use AIA Document B181 and HUD amendment in Appendix 70.)
- * Assurance of Completion:
  - Performance Bond (FHA-2452), (Appendix 27a)
  - Completion Assurance Agreement (HUD-92450), or (Appendix 27b)
  - Personal Undertaking (FHA-2459) (Appendix 27c)
(Initial closing documents - con't.)

(12-5) * Escrow Agreement for Offsite Facilities (FHA-2446) (Appendix 28)
* Assurance of funds to meet operating deficits (FHA-2476
  (Appendix 29a), FHA-2477 (Appendix 29b) and FHA-2476a
  (Appendix 29c))
* Agreement and Certification (Appendix 33a)

A. Mortgage (or Deed of Trust)

1) Must be on an FHA or HUD form or substitute approved in
   writing by HUD for use in the project jurisdiction.

2) Must be a first lien on the entire property.

B. Note

1) Must be on HUD-FHA form or substitute approved in writing
   by HUD for use in the project jurisdiction.

2) Must have a maturity of the earlier of 40 years or 75%
   percent of the estimated remaining economic life of the
   physical improvements.

3) Must identify on the panel of the note:
   a) The section of the Act and the regulations under which
      the mortgage is coinsured.
   b) Percentage of loss assumed by the lender and HUD,
      computed after allowance for the 5 percent deductible.

4) May contain prepayment provisions as follows:
   a) Lender and mortgagor may agree to reasonable conditions
      or penalties for prepayment as long as mortgagor's
      basic right to prepay upon 30-days notice is maintained
      subject to exceptions in paragraph c, below.
   b) Lender may collect a late charge not to exceed $.04 per
      $1.00 for each payment to interest and principal more
      than 15 days late (or other charge agreed to by the
      lender and HUD). Late charges must be separately
      charged to and collected from the mortgagor and cannot
      be deducted from any aggregate monthly payment.
   c) Exceptions:
      1. Bond-financed cases. The note may contain a
         prepayment restriction and prepayment penalty
(Initial closing documents - con't.)

(12-5) 2. Projects subsidized under Section 8 of the U. S. Housing Act of 1937 or other Federal law or subject to GNMA purchase, assignment, or other transfer must meet the prepayment restrictions of these programs.

5) The note and mortgage may contain standard exculpatory language acceptable to HUD. Among other things, any such language must specifically refer to the retained obligation of the individuals under the regulatory agreement.

C. Coinsurance Regulatory Agreement. Must be incorporated by reference into the mortgage. The lender may regulate and restrict the mortgagor (with prior HUD Headquarters written approval) on other matters as long as they do not conflict with HUD requirements.

D. Building Loan Agreement. Sets out responsibilities and operating terms and conditions between lender and mortgagor, including the bases under which coinsured advances may be made during construction.

E. Mortgagor's Certificate. Obligates mortgagor to comply with various requirements, including civil rights, during the coinsurance period.

F. Mortgagor's attorney's opinion. Must be on letterhead of the mortgagor's attorney and state the following:

"To: (Insert name of lender)

"I am the attorney for the mortgagor and have prepared or reviewed all of the documents on the organization of the mortgagor entity for cases using Section 103(b)(4)(A) tax-exempt bond financing, add here "and the financing of the mortgage with bonds tax-exempt under Section 103 of the Internal Revenue Code; the note, mortgage (deed of trust), regulatory agreement and other collateral documents submitted to you.

"It is my opinion that:

"1. The mortgagor is a valid existing legal entity; it has authority to engage in the business contemplated by this transaction; all incorporation fees and taxes have been paid; all pertinent security requirements have been met; the note,
mortgage (deed of trust), regulatory agreement and other collateral documents required by the lender to be signed by the mortagor have been signed by the person(s) authorized to do so and are instruments legally binding on the mortgagor; and the mortgage (deed of trust) is a valid lien on the

(Initial closing documents - con't.)

(12-5) "2. The building permit(s) has (have) been legally issued and construction (rehabilitation) in accordance with the plans and specifications is authorized by this (these) permit(s).

"3. The proposed construction (rehabilitation) complies with all applicable zoning laws and requirements. There is no legal action pending and, to the best of my knowledge, there is no threatened legal action or proposed changes in zoning that would affect this transaction in any manner.

"4. I certify that satisfactory arrangements have been made for payment of my fees for services and that I will assert no claim or lien because of such services against the mortgaged premises, mortgage proceeds or income from the premises.

"5. Add for cases using Section 103(b)(4)(A) tax-exempt bond financing  Any contracts or other documents executed by the mortgagor or any other arrangements agreed to by the mortgagor in order to finance the mortgage with bonds exempt from taxation under Section 103 of the Internal Revenue Code are consistent with the mortgage, mortgage note, Regulatory Agreement, Building Loan Agreement, Construction Contract, and all other documents executed by the mortgagor and submitted to the lender in connection with the mortgage transaction."

G. Title policy. The lender must determine that marketable title to the property is vested in the mortgagor on the date the mortgage is recorded.

1) The mortgagor must supply the lender with:

   a) Title insurance policy issued by a company in satisfactory form that:

      1. Names as the insured the lender and the Secretary of HUD as their interests may appear.

      2. Provides that, upon acquisition of title by the lender, it will become an owner's policy running to the lender and HUD as their interests may appear.
b) Surveyor's Plat, certified as described on the back of the
Surveyor's Certificate (Form FHA-2457) and dated, signed
and sealed within 90 days of initial closing.

c) Surveyor's Certificate, signed within 30 days of initial
closing by a licensed surveyor and bearing the surveyor's
professional seal.

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(Initial closing documents - con't.)

(12-5) 2) If, for reasons satisfactory to the lender, title insurance
cannot be supplied, the mortgagor must furnish:

a) Abstract of title, prepared by an abstract company or
person engaged in the business of preparing abstracts of
title, and

b) Legal opinion as to the quality of the title, signed by
an attorney experienced in the examination of titles.

H. Hazard insurance policy. All insurance polices must have a loss
payable clause with the lender and HUD named as their interest
may appear. The amount must at least equal the coinsured mortgage.
(See Chapter 8.)

I. Construction contract. You must use the HUD Construction Contract,
Form HUD-92442. The basis of payment under the contract depends
on whether there is an identity of interest between the mortgagor
and general contractor. (See Article 21 of the contract for
definition of identity of interest.) The lender must ensure that:

1) The maximum cash amount payable is the same as the amount
on line 4 of the Form FHA-2283, Financial Requirements for
Closing, and the allowed construction period is not longer
than the number of months on line 52, Part G, Form HUD-92264.

2) The contract is acceptable, signed, and based on the Agreement
and Certification.

3) A signed copy of Form FHA-2328, Contractor's and/or Mortgagor's
Cost Breakdown, is attached.

(See Chapter 7 and Appendix 70.) Covers architectural services
during project design and construction. The architect during
construction (mortgagor's inspecting architect) can have no
identity of interest with the mortgagor or general contractor.

K. Assurance of Completion. The mortgagor must supply assurance of
The lender may set up more stringent criteria but must at least require,

1) Assurance by bonds issued by a surety company (Use Form FHA-2452; see Appendix 27a) for payment and performance for 100 percent of the estimated construction or rehabilitation cost (Any surety on the accredited list of the U. S. Treasury published yearly in the Federal Register is acceptable up to the bonding limit stated in the list.); or

2) A completion assurance agreement (Use Form FHA-2450 in Appendix 27b) secured by a cash deposit or letter of credit for 15 percent of the estimated construction or rehabilitation cost (or 25 percent for elevator structures of four or more stories); or

3) A personal indemnity agreement (Use Form FHA-2459; see Appendix 27c) signed individually by the controlling principals and the general contractor and their spouses where the estimated cost of construction or rehabilitation is $500,000 or less.

Determine the estimated construction or rehabilitation cost by:

- Deducting the amount of architect's fees from total for all improvements and other fees that are not contractor obligations.

- Adding a typical builder's profit in BSPRA cases.

L. Completion assurance for off-site improvements. Except where a public body has, by agreement acceptable to the lender, agreed to install utilities and streets without cost to the mortgagor, one of the following must assure installation of required offsite public utilities and streets:

1) A cash escrow deposited to you or an escrow agent acceptable to you, or a letter of credit. The amount must equal the greater of your estimate or the mortgagor's estimate of cost of offsite facilities. Use Form FHA-2446, Escrow Agreement for Offsite Facilities, in this case.

2) Retention of a specified amount of mortgage proceeds. May be used only when cash available to the mortgagor, as shown in line 42 of Form FHA-2283, equals or exceeds the lesser of the lender's estimate of as-is value or the actual latest arms-length purchase price, plus the estimated cost of offsite construction.
NOTE: As additional assurance, you may require a surety company bond or bonds. You must use Form FHA-2479, Offsite Bond, in this case. (See Appendix 31.)

M. Mortgagee's Certificate (See Appendix 37). Necessary to assure HUD that the transaction has been properly accomplished, fees are within acceptable limits and required escrows have been collected.

N. Assurance of funds to meet operating deficits. If an operating deficit is projected on Form HUD-92264, you must require, without exception, funding of that deficit. The mortgagor must supply funds as a condition of the firm commitment to meet the deficit using paragraph 1 or 2, below.

(Initial closing documents - con't.)

(12-5) 1) Agreement of Sponsors to Furnish Additional Funds, Form FHA-2476. Must be accompanied by Bond Guaranteeing Sponsor's Performance, Form FHA-2477. The bond must equal the sum required for deposit by Form FHA-2476.

2) Additional Contribution by Sponsors, Form FHA-2476a. The amount required by the FHA-2476a may be:

- cash

- letter of credit

- United States bearer bonds with market value of at least 115 percent of the required amount of the escrow

The acceptance of a letter of credit or U. S. bearer bonds is solely your choice.

O. Agreement and Certification (Appendix 33a). Obligates mortgagor to certify its actual costs of project construction or rehabilitation costs and to disclose any identities of interest among project participants.

P. Collateral agreements. If any collateral agreements are necessary for unusual conditions encountered at closing, the mortgagor must submit signed duplicate copies acceptable to you.

12-6. HUD INITIAL ENDORSEMENT

A. After initial closing, the lender must submit the credit instrument for initial endorsement to the HUD field office with jurisdiction. The request for endorsement must be by letter signed by a senior corporate official certifying that:

1) The loan has been processed, underwritten, and closed in
full compliance with all program requirements and prudent business practice.

2) All parties requiring clearance under HUD's previous participation procedures have received it.

3) All conditions of the firm commitment have been satisfied.

4) HUD written approval has been obtained for:
   - Environmental review and Finding of No Significant Impact (FONSI)

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(HUD initial endorsement - con't.)

(12-6) - Affirmative Fair Housing Marketing Plan
- Intergovernmental review (if applicable)

5) Prevailing wages will be paid and all other labor standards and equal employment requirements followed.

6) You have (or have not) obtained reinsurance and, if so, the amount.

7) The project is (or is not) financed through the sale of bonds.

B. Attach to the letter:

1) Copy of your HUD 221(d) coinsurance preliminary approval letter.

2) If you have completed all pre-endorsement review requirements, the HUD letter granting full underwriting authority.

3) Copy of appraisal and a limited plan package that includes:
   a) Site plan with topographies, site improvements and buildings
   b) Front elevation
   c) First floor plan with dimensions
   d) Typical floor plan with dimensions
   e) Floor plans of all typical units
f) Brief specification reflecting current proposed specifications

g) Calculations of: common areas; commercial spaces; any special purpose areas; and cost not attributable

4) Copy of firm commitment with signed copies of Forms HUD-92264 and HUD-92264-A attached.

5) Mortgagee's Certificate (Appendix 37) and Mortgagee's Attorney's Opinion (Appendix 38).

6) Your check for .65 percent of the face amount of the mortgage for first year's MIP.

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(HUD initial endorsement - con't.)

(12-6) 7) Certified copies of mortgage (deed of trust) with attached regulatory agreement, note, and duplicate original of title policy. (If recorder-certified copies cannot be obtained in time for HUD endorsement, HUD may accept copies certified by the title company.) HUD will keep these documents.

8) A statement signed by an authorized senior corporate official that you have increased sound capital resources by $1 per $300 of the mortgage amount to be initially endorsed.

9) Completed Form FHA-290 (Closing Memorandum) (Appendix 25), if required by HUD field office with jurisdiction.

12-7. START OF CONSTRUCTION/EARLY START. Construction cannot begin before the closing and recording of the coinsured mortgage. In extreme circumstances where a construction delay could seriously jeopardize the project, you may permit an early start if you determine that:

A. There is a valid firm commitment outstanding; there is every reasonable assurance that closing will occur in the near future; and early start of construction will not be to HUD's or your detriment. Permission to start is granted by signing Form FHA-2415 (contractor, mortgagor, and lender) without any changes unless approved by HUD.

B. You may not grant permission to start unless you have approved final drawings and specifications.

C. HUD has no coinsurance obligation for costs incurred during an early start if the project does not reach endorsement (i.e., HUD will not share in any loss).
12-8. DOCKET PREPARATION. After initial endorsement, compile a separate docket for each coinsured mortgage for your permanent files containing the following documents filed chronologically:

A. Original signed or, if an original is unavailable because of filing or recording requirements, completely legible copies of all documents and correspondence about the project.

B. All processing (including worksheets, updates, and revisions clearly marked as such), internal memoranda, etc.

C. Initial endorsement documents, filed in a separate section.