
CHAPTER 13. CONSTRUCTION PERIOD

13-1. LENDER GENERAL RESPONSIBILITIES.

- A. Overall. You perform the HUD functions during construction as well as your usual lender functions. These responsibilities are critical because the likelihood of problems and defaults is higher during construction than at any other time in a project's life.

Monitor this high-risk period carefully and continuously by:

- Inspecting projects often
- Identifying problems immediately
- Taking corrective action promptly

- B. Inspections during construction. Inspect projects at least twice a month during construction or substantial rehabilitation to:

- 1) Evaluate performance of general contractor and mortgagor's inspecting architect.
- 2) Determine the physical progress to calculate advances.
- 3) Conduct routine employee wage interviews and check for posting of wage determinations and equal opportunity posters.
 - Payroll reviews are also required during construction but need not be done on-site.
 - Maintain files for review by HUD Labor Relations.
- 4) Ensure compliance with the contract documents.
- 5) Identify construction problems and delays (e.g., work stoppages, slowdowns, unforeseen soil problems).

Inspect projects with construction problems or delays more often to make sure immediate remedies are taken to prevent default.

NOTE: Your field inspector is not a project superintendent and may not have any identity of interest with the mortgagor or general contractor.

- C. Insured advances of mortgage proceeds. Approve payments based on construction progress documented in inspections and endorse each approved monthly advance for coinsurance. Review contractor's requisition and prevailing wage certificates. Keep the mortgage in balance at all times.
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(13-1) D. Change orders. Process construction changes (cost increases, or decreases for changes in plans, specifications and materials, and extensions of time) as they are requested.

1) When cumulative construction cost increases total more than \$2,500, you must require the mortgagor to escrow funds to pay for changes.

2) When increases total more than 10 percent of the contract amount, you must also obtain approval of the surety.

E. Cost certification. The law requires cost certification for all HUD-coinsured projects to ensure: the initially endorsed mortgage is supported by the allowable actual cost of the completed project; and the project is not over-mortgaged. You must:

1) Carefully evaluate the items and amounts in the required statements and certifications by the mortgagor, general contractor, and subcontractors (if applicable) and make adjustments as needed.

2) After you approve cost certification, determine whether a mortgage reduction is necessary.

3) Determine the final maximum coinsurable mortgage.

F. Administering project escrows. You must ensure that escrows set up during construction are properly established - i.e., through cash, letter of credit (see paragraph 12-4 for requirements for letters of credit) or, where specifically permitted, U. S. bearer bonds - and are released only as specified by the respective agreements and the rules of this handbook.

13-2. REQUIRED HUD FORMS DURING CONSTRUCTION. See paragraph 12-3, Revision of Forms, and Appendix 1 for a complete list of required and equivalent forms.

13-3. ADVANCES OF MORTGAGE PROCEEDS

A. Required submission from mortgagor/contractor. (May not be requested more than once a month):

1) Application for Insurance of Advance of Mortgage Proceeds, Form HUD-92403, filled out according to instructions on form.

2) Contractor's Requisition and Prevailing Wage Certificate, Form HUD-92448.

a) The completed form, signed by general contractor, mortgagor's inspecting architect and lender's inspector,

must accompany any request for advance that includes payment for construction costs.

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(Advances of mortgage proceeds - con't.)

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- b) The amount in the certification on the Form HUD-92448 must be the same as on line (11) in the lower half of the form (identified as "Less Previous Payments"). Otherwise, the contractor must explain the discrepancy, in writing, to the lender's satisfaction.
 - c) Prevailing Wage Certificate (reverse side of Form HUD-92448) must be completed, signed by contractor and accompany any request that includes payment for construction costs.
- 3) Survey of Improvements. The construction contract requires a survey showing the location of the improvements built on the site at any time the owner requests and at construction completion.
- 4) Title update. (To make sure no liens have been placed on the project since initial endorsement.)
- 5) Advances for carrying charges, financing expenses, etc. The Building Loan Agreement (Appendix 32), permits release of mortgage funds, if available, for carrying charges, financing expenses, etc.
- a) The amount in each line item on the HUD-92451, Financial Record of Mortgage Loan Transaction, must initially equal the amount on the corresponding line on the Form HUD-92264 (Appendix 5) and Mortgagee's Certificate (Appendix 37).
 - b) Except in rare cases, no funds may be released for an item in excess of the allocated amount. If it is necessary to prevent a default, the lender may:
 - 1. Agree to a reallocation of funds, and
 - 2. Make a corresponding cut in another line item.
- 6) Holdback of mortgage proceeds. The Building Loan Agreement requires that all advances have a 10 percent holdback of mortgage proceeds by the lender. The lender may increase the holdback requirement but not decrease it. (See paragraph 13-4.)
- B. Lender action. Endorse each advance by certifying the amount of the advance on the Form HUD-92403 and keep accounting records of amounts disbursed using Form HUD-92451. Mortgage credit staff has primary responsibility for reviewing the HUD-92403. (See

(Advances of mortgage proceeds - con't.)

(13-3) 1) Review. See that:

- a) All escrowed funds (except for offsite facilities and certain loans or grants made by Federal, State or local governments as provided in Chapter 18) and grant funds are disbursed fully before advance of any mortgage proceeds.
 - b) Advances are commensurate with documented percentage of construction progress and allowable fees.
 - c) Advances for construction items are reasonable and reflect the required holdback (See paragraph 13-4).
 - d) There is no fraud, waste or mismanagement.
- 2) Approval of advances. If the request is approvable, using the instructions below, complete the "Certificate of Mortgage Insurance" on the Form HUD-92403. Follow the instructions in Chapter 10 and Handbook 4470.1, Mortgage Credit Analysis, for approving advances.
- a) The first advance (usually made at initial closing) covers the mortgagor's early expenditures (e.g., design architect fees, first year's MIP, bond fees, insurance premiums, building permit fees, etc.) less any required front money unless funded pursuant to Chapter 18. Unless there was an early start under paragraph 12-7, no construction funds may be advanced at this point.
 - b) For subsequent advances, calculate the cumulative total, including the advance being requested, and see that there are no discrepancies.
 - 1. Materials stored on-site. You may insure advances for on-site materials if they are itemized by quantity and cost. (See Form HUD-92448.)
 - 2. Components stored off-site. You may insure advances (solely at your option) for manufactured or preassembled building components as defined by HUD if: the mortgagor has title to them; there is a valid security agreement that is a first lien on the components; and the other off-site storage requirements of Handbook 4430.1, Chapter 2, are followed.

- c) Final advance. Made at final endorsement and insurance of balance of mortgage proceeds available to mortgagor as a result of cost certification.
- d) Keep all originals in the project docket.

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(Advances of mortgage proceeds - con't.)

13-4. HOLDBACK OF MORTGAGE PROCEEDS. The holdback provides an incentive for the mortgagor and general contractor to:

- See that the job is completed promptly
- Submit cost certification
- Reach final endorsement

A. Amount of holdback. The Building Loan Agreement requires the lender to retain at least 10 percent of mortgage proceeds for each advance.

B. Basis for release after completion. After all required contractor cost certification documents are approved, the contractor is entitled (through the mortgagor) to release of the balance of the holdback less escrows for: punch list items; items of delayed completion; liquidated damages; and net effect of negative change orders, provided:

- 1) The lender has completed the contractor cost certification review and made appropriate adjustments to the HUD-92451, Financial Record and Mortgage Loan Transaction.
- 2) All work under the construction contract has been inspected and approved by government authorities having jurisdiction and by any rating or inspection organization, bureau, association or office having jurisdiction;
- 3) All certificates of occupancy, or other required approvals, for all units of the project have been issued by State or local governments having jurisdiction.
- 4) The lender has issued Permission to Occupy (Form FHA-2485) for all units of the project.
- 5) All Davis-Bacon payroll requirements have been satisfied.
- 6) Requisitions are accompanied by a Contractor's Prevailing Wage Certificate, Form HUD-92448, and a final survey.
- 7) Contractor has disclosed its final obligations on the Form FHA-2023.

- C) Projects in difficulty. You may permit an earlier release to prevent default of the construction loan if this will solve the project's problem and enable it to reach construction completion, in this case, take immediate control of disbursements of mortgage proceeds, using either your own staff or an escrow agent, and supervise payments to subcontractors and material suppliers (e.g., through two- or three-party checks).

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13-5. WORKING CAPITAL DEPOSIT. At initial endorsement, all mortgagors, other than nonprofit, must set up an escrow of at least 2 percent of the face amount of the mortgage by:

- cash
- letter of credit
- U. S. bearer bonds, or
- excess mortgage proceeds, if any

(The lender may require a higher amount)

A. Use the deposit to:

- 1) Defray cost of initial marketing and rent-up. This includes, for example, sales and advertising, model furnishings, and equipment and supplies essential to initial rent-up.
- 2) Set up accruals for items due during the first operating year that project income is not expected to cover. Includes: real estate taxes; permanent property insurance premiums; mortgage insurance premium; ground rents; and assessments.
- 3) Cover shortfalls in: interest; taxes; property insurance premiums; mortgage insurance premiums; ground rents; and assessments after funds available under the Building Loan Agreement are exhausted.

B. Control and release of escrow. The lender controls disbursements from the escrow. In reviewing a mortgagor's request for release of part of the escrow, consider the following:

- 1) None of the escrow can be used to defray any of the hard costs of construction applicable to the Total for All Improvements, Section G of Form HUD-92264, Rental Housing Project Income Analysis and Appraisal.
- 2) Avoid premature disbursements and unnecessary or extravagant expenditures.

- 3) As portions of a project are ready for occupancy, you may permit a partial disbursement for reasonable opening expenses; however, see that the escrow is not exhausted before the entire project is complete.
- 4) You must fully document all expenditures from the escrow.

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(13-5) C. Cost certification of working capital escrow. The mortgagor's cost certification may include monies spent from the working capital escrow.

D. Final release of escrow

- 1) If the mortgage is not in default, you generally may release the rest of the working capital escrow to the mortgagor one year after the construction completion date.
- 2) If the project's financial condition is poor (e.g., has not reached sustaining occupancy, has poor liquidity or high payables, is operating at a deficit or is near default), you may hold this escrow until the financial problems are resolved.
- 3) If the project defaults before release of the escrow, consider using it to cure the default. (See paragraph 13-9 C.)

13-6. PAYMENT FOR OFFSITE FACILITIES. The Escrow Agreement for Offsite Facilities, Form FHA-2446, is to ensure construction of these items.

A. Releasing escrowed funds. You may do this during construction of the facilities if you find the construction satisfactory and:

- 1) Funds released do not exceed the documented percentage of offsite work actually completed, less a 10 percent holdback;
- 2) The mortgagor sends you a Request for Approval of Advance of Escrow Funds, Form HUD-92464 (original and one copy); and
- 3) You evaluate the request and complete your part of the form.

B. For an approved request:

- 1) Sign and keep the original for the project docket.
- 2) Send a copy to the mortgagor.

C. For a disapproved request. Return it to the mortgagor. Attach an explanation for denying the release.

13-7. LABOR STANDARDS AND PREVAILING WAGES. HUD is responsible for administration and enforcement of Davis-Bacon labor standards. Certain day-to-day duties and monitoring are delegated to lenders. Follow the instructions for local and State Agencies in Handbook 1344.1, Federal Labor Standards Compliance in Housing and Community Development Programs. Among other things, during construction you must:

- A. Establish a construction contract management system meeting the standards of Attachment O of OMB Circular A-102.

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(Labor standards and prevailing wages - con't.)

(13-7) B. Ensure all bid documents, contracts, and subcontracts contain Federal labor standards provisions and the applicable Department of Labor wage determination obtained from HUD. (See paragraphs 6-13 and 12-2.)

C. See that no contractor is ineligible for Federally-assisted work. Check HUD's current "List of Debarred, Suspended, or Ineligible Participants" or the General Service Administration's "Consolidated List of Debarred, Suspended, and Ineligible Contractors." Obtain these lists from the HUD field office with jurisdiction.

D. Conduct on-site inspections including:

1) Routine employee wage interviews.

a) HUD will conduct all interviews required as part of a major investigation.

b) Do not disclose statements made by employees during wage interviews to anyone other than HUD or the Department of Labor.

2) Checks for posting of wage determinations and equal opportunity posters in conspicuous places on the construction site.

See paragraph 3-2 of Handbook 1344.1 for details.

E. Review weekly contractor payrolls and make wage comparisons.

F. Ensure all violations of labor standards are corrected immediately.

G. Report uncorrected violations promptly to HUD field office with jurisdiction for enforcement pursuant to paragraph 3-4e of Handbook 1344.1.

H. Keep fully documented files showing all administration and enforcement of Federal labor standards requirements, including:

- 1) Weekly payrolls.
- 2) Copies of wage determinations and any applicable changes or modifications.
- 3) Construction start notices.
- 4) On-site inspection reports and employee interviews.

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(Labor standards and prevailing wages - con't.)

- (13-7) 5) All other records used in enforcement or administration (e.g., preconstruction conference minutes, attendance sheets, and records of any wage restitution).
- I. Withhold mortgage advances in cases of substantial wage violations and defer the final advance and final endorsement if violations are not being corrected.
- J. Establish wage escrows of 100 percent for known differences at final endorsement. These escrows must be deposited and administered by HUD pursuant to paragraph 3-4h of Handbook 1344.1

All labor standards and prevailing wage files are subject to review by HUD Labor Relations staff. Only HUD can conduct labor standards investigations pursuant to Chapter 4 of Handbook 1344.1.

13-8. REQUESTS FOR CONSTRUCTION CHANGE, FORM HUD-92437 (CHANCE ORDER). All requests for changes in drawings or specifications or for extensions of time must go to the lender on Form HUD-92437 for approval, completed on the front, dated, and signed by the mortgagor, general contractor, and mortgagor's inspecting architect. Process change orders using instructions in this chapter and Handbooks 4460.1 and 4480.1.

- A. The owner has the right to request changes in the work.
- B. You must give written approval before any changes are made.
- C. You must restrict your approval of changes to those essential to fulfill the intent of the contract documents, that result in an actual project betterment, or are necessary pursuant to paragraph E, below.
- D. You must obtain written approval of the surety when a change, or accumulation of changes, increases costs by 10 percent or more

of the construction contract amount.

E. Necessary changes are those that arise from:

- 1) Differing site conditions (as defined in construction contract).
- 2) Errors or omissions of the architect.
- 3) Compliance with local codes.
- 4) Unforeseen conditions that may affect safety and health of occupants.
- 5) Betterments that are economically justified (e.g., those that produce significant cost savings to project operation).

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(13-8) F. Lender action on acceptable change. Sign all copies of Form HUD-92437 and distribute one each as follows:

- Your files (original)
- Mortgagor and general contractor
- Your construction inspector assigned to the project

G. Increases in construction cost resulting from approved change orders. (See paragraph 13-15 for instructions.)

H. Extension of time to complete construction. The mortgagor and contractor may ask to amend the construction contract.

1) Filing for an extension

- a) Must be on HUD-92437, signed by mortgagor, general contractor and mortgagor's inspecting architect.
- b) No extension will be approved unless the delay was beyond the contractor's control (e.g., weather, strikes, differing site conditions, etc.) and is documented.
- c) Requests for extension must meet the time limit set by the construction contract.
- d) Where the delay is the contractor's fault or requests have not been filed promptly, the extension may not be granted and the provisions of Article 3 (liquidated damage clause) of the construction contract will be enforced against the contractor.

2) Lender action

- a) Obtain written consent of the surety.
- b) Process a change order according to Article 7 of the construction contract.
- c) Calculate the cost increase due to extension (i.e., contractor general requirements, overhead, construction loan interest, taxes, insurance, MIP, extension fees).
- d) Determine source of funds for any increase due to the extension.

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13-9. PROBLEMS DURING CONSTRUCTION

A. Work stoppages, construction defects, etc. The lender must resolve construction problems, cure defaults and see that projects are completed and reach final endorsement promptly. You must monitor projects during construction to ensure that problems or defects are noted immediately and remedied as quickly as possible. Construction problems that may lead to default include:

- 1) Work stoppage
- 2) General contractor or major subcontractor abandoning job
- 3) A change in owner, architect or general contractor during construction
- 4) Construction defects untreated for 30 days
- 5) Extended periods of bad weather, strikes, etc.

Lenders should immediately contact the mortgagor, general contractor, surety, or other interested parties regarding construction problems to identify causes and remedies to avoid default.

B. Defaults during construction. Regardless of the cause, the lender must consider what relief can be offered to avoid foreclosure and hardship to all concerned.

- 1) Assess the situation by considering:
 - a) Percentage of construction complete
 - b) Occupancy (including current estimates of income, expenses and occupancy projections)

- c) Type of assurance of completion (personal guarantees, bonds)
 - d) Status of escrow deposits
 - e) Undrawn amount of letters of credit (including working capital)
 - f) Any other pertinent information
- 2) Call all parties with a direct or indirect interest together and explain the consequences of default for both the project and the participants. Besides the operating remedies covered in paragraph 4, below, all parties should consider basic restructuring of the project's finances such as:

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(Defaults during construction - con't.)

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- a) Infusion of new capital through adding partners, syndication, or other investments.
 - b) Concessions by the coinsuring lender to avoid a loss (e.g., deferral or forgiveness of interest, taking a partial assignment of the partnership interest, etc.).
- You must get HUD approval if this creates an identity of interest with the mortgagor.
- 3) Preserve your rights against the surety by prompt oral and written notification of the principal's default and by demand for performance under the contract of surety.
 - 4) If the default cannot be cured promptly, consider remedies, such as:
 - a) Calling on the bonding company to perform. This should include recommendations on negotiations with surety and actions to be taken where surety is unwilling to perform. (Refusal of the surety to honor its obligations should be reported to HUD Headquarters, Office of Insured Multifamily Development.)
 - b) Possible mortgage increase (See paragraph 13-15).
 - c) Issuing two- or three-party checks or otherwise taking control of disbursements of insured advances.
 - 1. May be done by you or through a title company.
 - 2. See that all money drawn for construction is actually

paid to subcontractors, suppliers, and workers on the job.

3. See that money drawn for specified purposes (architect's fees, insurance premiums, taxes,, etc.), is not diverted to other uses.
- d) Releasing any escrow funds if there is reasonable assurance that the release will cure the default and lead to final endorsement.
1. When the balance of the mortgage proceeds alone or in combination with the mortgagor's available assets cannot complete the project, release of escrow funds may offer a chance of completion and final endorsement with clear title.

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(Defaults during construction - con't.)

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2. This is most likely when the project is nearly complete. In such cases, remaining escrow funds may be released (except for 2-1/2 percent of the contract sum to cover latent defects).
 3. Do not approve any release until you make proper provision for all payments required of the contractor. The funds to be disbursed concurrently with additional contributions by the mortgagor must be under the strict control of you or a title company.
 - e) Deferring amortization if the project is complete and ready for occupancy but cannot get to final endorsement.
 - f) Immediate rent increase, if the project is occupied and the market will bear higher rents.
 - g) Reanalysis of cost certification (where final endorsement has not occurred) to see whether all allowable costs were included.
 - 5) Provide the mortgagor with written notice of violation with 30 days for correction (See Handbook 4566.2 on servicing).
 - 6) Report monthly to HUD on the default and describe your plan for curing it using Form HUD-58047, Default Report Before Final Endorsement (Appendix 71). Submit it to the Office of Insured Multifamily Housing Development in HUD Headquarters and to the HUD field office with

jurisdiction.

- a) Reinstatement plans requiring a mortgage increase must be approved by HUD Headquarters.
- b) HUD may extend the 75-day deadline for submission of the lender's Notice of Election to Acquire and Intent to File a Claim. (See Handbook 4566.2 on servicing.)

NOTE: The Form HUD-58047 is not available from HUD field offices. Obtain copies from the Coinsurance Branch, Office of Insured Multifamily Housing Development.

13-10. ACQUIRING AND DISPOSING OF UNCOMPLETED PROJECTS. If a project defaults during construction and the default cannot be cured, the lender must:

- A. Acquire title through foreclosure or voluntary conveyance by the mortgagor.
- B. Secure the property against theft and vandalism. Make sure fire and hazard insurance is in force. Obtain new insurance if necessary.

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(13-10) C. Follow Handbook 4561.2 on servicing for claim procedure and payment of insurance benefits, including the requirement for appraisals. You must establish a date of default to file a claim.

If you choose to complete the project yourself, HUD must approve the completion plan and budget.

13-11. SUBSTANTIAL COMPLETION: The date on which the lender determines that all work required by the construction contract is satisfactorily performed except for punch list items and items of delayed completion (as long as the estimated cost to complete these items is not more than 2 percent of the contract sum).

- A. Punch list items are work the contractor is required to complete that does not preclude occupancy or use of the project.
- B. Items of delayed completion are the same as above except that they have not been completed for reasons beyond the contractor's control (e.g., weather).

13-12. ESCROW FOR INCOMPLETE ITEMS. When there are such items, you must set up an escrow of 2-1/2 times your estimate of cost of completion. (See paragraph 14-7 for closeout of this escrow.)

13-13. PERMISSION TO OCCUPY. Before final endorsement, the mortgagor may request permission to occupy parts of the project as they are

ready. The lender must certify on Form FHA-2485 or equivalent that the project (or stage):

- A. Has been constructed according to contract documents and inspected pursuant to Chapter 7.
- B. Is suitable for occupancy, including the means of access, with all fixtures, equipment and utilities installed, connected and operating.
- C. Has received a certificate of occupancy and any other government approvals necessary for occupancy.
- D. Meets the property insurance requirements of Chapter 8.
- E. Has a signed and approved management agreement between the owner and the agent. (See Chapter 11.)

13-14. COST CERTIFICATION. Required by law for multifamily projects including those coinsured under 221(d). Must be submitted and approved by the lender before final endorsement.

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(Cost certification - con't.)

(13-14) A. General. Only costs that have been paid in cash or will be paid in cash within 45 days of final endorsement are certifiable.

- 1) The amounts allowable for general overhead and BSPRA where there is an identity of interest between the builder and mortgagor are also cost certifiable, whether or not paid in cash.

- 2) Use Forms FHA-2330, HUD-92330-A and FHA-2580.

B. Simplified cost certification. No accountant's opinion is needed for either the mortgagor's or general contractor's certifications.

- 1) Simplified cost certification is permitted for:

- a) Projects involving 40 units or less

- b) Projects involving mortgage amounts not in excess of \$200,000

- 2) If there is an identity of interest between the mortgagor and general contractor or subcontractor, materialmen and equipment lessors, Form FHA-2330 must be supported by Form HUD-92330-A.

- 3) Unaudited balance sheet dated the same as the cut-off date is needed.
 - 4) Unaudited operating statement is needed if occupancy occurred before cut-off date.
- C. Long form cost certification is required in all cases that do not qualify for simplified cost certification outlined above.

- 1) Mortgagor's Certificate of Actual Cost, Form FHA-2330, and contractor's certificate of Actual Cost, Form HUD-92330-A, must be supported by an accountant's opinion.
- 2) Contractor's Certificate of Actual Cost, Form HUD-92330-A, is needed for all projects where there is an identity of interest with the mortgagor and/or where a cost plus construction contract was used.

Note: Subcontractor, suppliers and equipment lessors with an identity of interest with either the mortgagor or general contractor must submit Form HUD-92330-A.

- 3) Audited balance sheet dated the same as the cut-off date is in need in all cases.
- 4) Audited Operating Statement is needed if occupancy occurred before the cut-off date.

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(Cost certification - con't.)

(13-14) D. Lender action

- 1) Evaluate the cost certification using instructions in Chapter 10 and Handbooks 4470.1, 4470.2 and IG 4200.1A.
- 2) Compute the maximum coinsurable mortgage, using Form FHA-2580 or equivalent. Sign the form, send a copy to the mortgagor, and put the original in the project docket with the cost certification exhibits, your review documents, notes, etc.
- 3) If the FHA-2580 shows a reduction of the initially endorsed mortgage is necessary, finally endorse the mortgage at the lower amount or through mandatory prepayment as required by the Agreement and Certification (Appendix 33a). Do not require prepayment of amounts less than 1 month's scheduled principal payment. Add these small amounts to the project's reserve for replacement
- 4) See paragraph 10-9 for instructions on setting up an escrow to pay all obligations not paid as of final endorsement.

- 5) Cost certification incontestable. After you approve the certifications, they are final and incontestable except for fraud or material misrepresentation by the mortgagor, general contractor, or subcontractors.
- 6) Recovering excess monies released. If the cost certification shows too much money was released to the contractor, recover it from the contractor or surety.

13-15. INCREASE IN COINSURED MORTGAGE AMOUNT.

- A. Timing. Do not consider a request for mortgage increase until the project is complete, cost certification is complete, and final endorsement will likely be achieved immediately following processing of the mortgage increase.
- B. Bases for considering mortgage increase. To cover:
 - 1) Allowable changes described in paragraph 13-8 E.
 - 2) Costs caused by extensions in construction time, when such extensions were: approved by the lender; justifiable under AIA General Conditions; and caused by problems beyond the contractor's control.
 - 3) Other costs not known at firm commitment resulting from requirements of local authorities and beyond the mortgagor's control.

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(Mortgage increases - con't.)

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- 4) Construction (hard) cost increases caused by a natural disaster declared by Federal or State government, to the extent not covered by casualty insurance.
 - 5) Increased costs resulting from concealed subsurface site conditions, provided the lender finds that exploratory tests during project design were sufficient and thorough and neither the architect nor engineer were at fault.
 - 6) Cost of substituting general contractor when original contractor is terminated for cause and the surety has failed to perform. (Report any nonperformance by a surety to HUD Headquarters, Office of Insured Multifamily Housing Development.)

C. Any mortgage increase must be:

- 1) More than 2-1/2 percent of the original mortgage and at least \$50,000.

- 2) Approved by HUD Headquarters (Office of Insured Multifamily Development) if it exceeds 7.5 percent of the original mortgage amount.

D. Lender action

- 1) General. Before processing any request for increase, see if it is eligible under paragraph B above. Process using this chapter and chapter 10, fully justify the increase, and document your files completely.
 - a) Analyze the reasons for the increase and evaluate the project's potential success in reaching endorsement if the increase is approved.
 - b) Consider what other solutions are possible (e.g., infusion of new capital through new partners, syndication proceeds, etc.).
 - c) Revise Form HUD-92264 to show the approved increases.
 - Do not increase BSPRA.
 - Do not include nonmortgageable items (including but not limited to: construction loan extension fees; discounts; and rate maintenance fees).
 - Offset nonmortgageable items by net income earned during construction.
 - Apply any remaining net income to offset amount of mortgage insurance

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(Mortgage increases - con't.)

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 - d) Compute the new mortgage using current rents, expenses, and occupancy ratios.
 - e) The obtainable market rents must be enough to support the higher mortgage.
 - f) The portion of mortgage attributable to the increase may have a construction and permanent interest rate greater or less than the original.
- 2) Special instructions for declared natural disaster or change in general contractor:
 - a) The revised cost of the project should consider increased carrying charges, financing fees, and legal fees.

However, do not include any cost because of construction delays before the disaster.

- b) Review new Form FHA-2328, Contractor's and/or Mortgagor's Cost Breakdown (Schedule of Values), from the general contractor showing increased hard costs associated with the physical construction and/or loss of general contractor or major subcontractors for the new or remaining work.
- c) Cut the new estimated replacement cost by the amount of any actual recovery through insurance proceeds.
- d) Require repayment of 90 percent of any late recovery.

E. Reopening a mortgage transaction

- 1) A mortgage increase does not change the maturity date of the mortgage.
- 2) The following fees are the maximum allowable on the mortgage increase:
 - a) Examination fee: \$3.00 per thousand.
 - b) Inspection fee: \$5.00 per thousand. (Only when the increase involves construction (hard) costs.)