CHAPTER 7. INITIAL CLOSING TO CONSTRUCTION START

7-1. PREPARATION FOR INITIAL CLOSING. The Area Manager has the authority and responsibility or notifying all parties, and for arranging the closing date and place. Once a closing date is set, postponement should not be permitted unless absolutely necessary. Among the matters to be considered when scheduling the initial closing are the following:

a. All closing documents should be submitted, reviewed and approved by the Area Manager and the Area Counsel prior to the closing date.

b. Closing should be held in the city within the Office's jurisdiction which is most convenient, taking into consideration the fact that the presence of the land owner and others may be required to obtain clear title, record the mortgage and satisfy other requirements prior to releasing the first disbursement.

c. If an Area Office Attorney is unavailable, the Area Counsel should notify the Regional Counsel. The Regional Counsel may authorize travel by either an attorney from another Area Office or a Regional Office Attorney to handle the closing.

7-2. RESPONSIBILITIES OF HUD AREA MANAGER AND AREA COUNSEL. Compliance with the conditions of the Firm Commitment is the responsibility of the Area Manager. The legal sufficiency of any document in connection therewith is the responsibility of the Area Counsel.

7-3. ADDITIONS OR DELETIONS TO STANDARD FORMS. The forms discussed in this Handbook are to be used without change except for additions or deletions which are not of a substantive nature or which are required by local law or procedures.
Headquarters if a legal form is involved, or to the Office of Multifamily Housing Development if an administrative form is involved.

d. A written recommendation from the Area Counsel (legal forms) or Area Manager (administrative forms) should be attached to each such request referred to Headquarters.

7-4. DOCUMENTS REQUIRED AT INITIAL CLOSING. The documents generally required at initial closing are listed in Form FHA-1022-EH, Legal Requirements for Closing - Section 202, and are self-explanatory, except as discussed in the paragraphs below. Additional documents may be required because of special circumstances of an individual loan.

7-5. TITLE POLICY. Responsibilities as to title evidence are divided. The Area Manager is responsible for determining the acceptability of the title company while the Area Counsel has responsibility for acceptability of title. The Area Counsel is required to bring to the attention of the Area Manager any restrictions or covenants affecting the title. The Area Manager, in turn, is responsible for seeing that the proposed project, when completed, will not violate the restrictions and covenants cited. The Area Manager shall determine that any title exception does not affect adversely the value or marketability of the project. If a clear determination cannot be made, the question is to be presented to the Director, Office of Multifamily Housing Development.

7-6. CONTROL OVER BORROWER. A Regulatory Agreement, Form FHA-2466-EH, must be executed by the Borrower.

7-7. CONSTRUCTION CONTRACT. Form FHA-2442A-EH, Construction Contract Cost Plus, with a fixed upset price, will be used in all cases. However, Article 3.A.(2) of the Form shall be revised to read as follows: "In addition to any cash fee provided for in paragraph (1) Owner shall pay to the Contractor by means other than cash, the following:"

a. The Date. Unless prior written approval of a later date is obtained from the Director, Office of Multifamily Housing Development, the date to be inserted in Article 2 will not be later than a date which is derived by adding to the date of the contract the number of months specified on Line 52, Part G, of Form HUD-92264.

(1) If the Borrower and the general contractor agree on an earlier date, such earlier date may be inserted.

(2) The daily amount to be inserted in Article 3 is to be computed at 24 cents per thousand dollars of loan amount.
based on 6 percent interest rate, or such larger amount as may be agreed upon between the Borrower and the general contractor. For each additional 1/8 percent of interest the amount will be increased by one-half of one cent per day.

(3) For Example: using a 7-3/8 percent interest rate, the daily liquidated damages will be computed at 29 and one-half cents per thousand dollars of loan amount.

b. The Area Manager is responsible for assuring that the maximum cash amount payable under the contract coincides with the amount shown on Line 4 of Form FHA-2283, and that the construction period allowed by the contract is not in excess of the number of months shown on Line 52, Part G, Form HUD-92264.

c. An incentive payment provision may be included in the construction contract so that the general contractor may share the benefits of any savings in interest charges, taxes, and insurance as a result of completing the project earlier than the completion date specified in the construction contract. Where the parties choose to use the incentive payments rider, the Construction Contract-Cost Plus shall be modified in the manner specified in Form HUD-92443, Construction Contract Incentive Payment.

(7-7) d. At initial closing, there must be attached to the contract, as exhibit, a copy of the Contractor's and/or Mortgagor's Cost Breakdown, Form FHA-2328.

e. An identity of interest between the Borrower and the general contractor is prohibited under the Section 202 program and will be construed to exist:

(1) If there is any financial interest of the Borrower in the general contractor;

(2) If any of the officers or directors of the Borrower is also an officer, director, or stockholder of the general contractor;

(3) If any officer or director of the Borrower has any financial interest whatsoever in the general contractor;

(4) If the general contractor advances any funds to the Borrower; including providing a land option or any of the costs of obtaining a land option;

(5) If the general contractor provides and pays, on behalf of the Borrower, the cost of any Architectural or engineering
services other than those of a surveyor, general superintendents, or engineer employed by a general contractor in connection with his/her obligations under the construction contract;

(6) If the general contractor has any interest in the Borrower corporation as part of the consideration for payment;

(7) When there exist (or come into being) any side deals, agreements, contracts or undertaking entered into or contemplated, thereby altering, amending, or canceling any of the required closing documents.

7-8. MATERIALS STORED OFFSITE. For instructions concerning the handling of advances of loan proceeds for certain materials stored offsite, see Handbook 4430.1 Chg.

7-9. OWNER-ARCHITECT AGREEMENTS.

a. Agreement Format. An agreement between the licensed professional architect and the Borrower for architectural services shall be submitted as soon as the appropriate form has been executed, but no later than at the time of submitting an application for Conditional Commitment (or Firm Commitment if the former stage is being by-passed). Design should not begin until an agreement has been executed. The executed agreement

shall be AIA Document B181, Standard Form of Agreement Between Owner and Architect for Housing Services. It shall include the HUD Amendment (Appendix ). Note: The term Owner as used in the AIA B181 Document and the HUD Amendment shall refer to the Borrower under the Section 202 program. Also, all references to the mortgagee in the HUD Amendment shall be deleted.

(1) The scope of services shall include all architectural, structural, mechanical, electrical, civil, landscape, and interior design and consulting services necessary to prepare drawings, specifications and other documents setting forth in detail the requirements for construction of the project. The scope of services shall also provide for administration of the construction contract.

(2) The scope of services shall designate the responsibility for the services to be provided, whether by the Architect, Owner (Borrower), or others.

(3) There may be separate agreements for design and construction services if the same architect is not employed for both. Where there is a separate agreement for administration of the construction contract, it must
be submitted not later than initial closing. Where separate agreements are made, those sections not applicable shall be deleted.

b. Identity of Interest. An identity of interest between the architect and the Borrower or general contractor is prohibited; however, where service rendered is donated an identity is not considered to exist. An identity of interest will be construed to exist:

(1) When the licensed professional, referred to as the architect, has any financial interest in the project other than the fee for professional service;

(2) When the Sponsor/Borrower or contractor or any officer, director, stockholder, or partner of such Sponsor/Borrower or contractor has any financial interest whatsoever in the architectural firm;

(3) When the architect has stock or any financial interest in the Sponsor/Borrower or contractor.

(4) When the Sponsor/Borrower or contractor or any officer, director, stockholder or partner of such Sponsor/Borrower or contractor provides any of the required architectural services; or where the Sponsor/Borrower or contractor, or any officer, director, stockholder or partner of such Sponsor/Borrower or contractor, while not directly providing an architectural services, acts as a consultant to the project architect.

(5) When there exists (or comes into being) any side deals, agreements, contracts or undertaking, thereby altering, amending, or cancelling any of the required closing documents.

c. Architects' Fees.

(1) Loan disbursements for architect's fee at the time of initial closing and subsequent interim disbursements shall be in accordance with procedures as set forth in Handbook 4470.1 REV, Mortgage Credit Analysis for Project Mortgage Insurance, Section 207. In the event a Section 106(b) loan is used, up to 25 percent of the architect's fee may be funded by the Section 106(b) loan upon completion and approval of the final plans and specifications by the Field Office (see Handbook 4535.3 REV-1, Section 106(b) Nonprofit Sponsor Assistance Loans for Section 202 Projects for the
Elderly or Handicapped).

(2) In the event the first request for loan disbursement (Form HUD-92403-EH) includes an amount for payment(s) to the architect, a Form FHA-2403-1, Mortgagor's and Architect's Certificate, must be submitted. The amount requested in the draw may not exceed the amounts shown on Form FHA-2403-1.

(3) If no loan disbursement for the architect is included in the first draw, Form FHA-2403-1 need not be required. The first request which does include an amount for architect's fees must be accompanied or preceded by submission of the Form FHA-2403-1.

7-10. ASSURANCE OF COMPLETION. HUD standardized requirements, which are described below, are minimum requirements imposed primarily for HUD's own protection. Nothing in these instructions will be construed as limiting or restricting the absolute right of the Borrower to impose additional or stricter requirements, but the HUD requirements will not vary from the amounts prescribed below:

a. For all types of structures, a 50 percent performance-payment bond shall be provided.

b. In lieu of the performance-payment bond (each in the amount of 50 percent of the construction cost), the contractor may furnish a 25 percent cash escrow to be held in an approved depository.

c. The amount of the bond or escrow shall be 50 or 25 percent, respectively, of the construction cost (line 50, Form HUD-92264, less architects fees).

d. Form FHA-2452-EH, Performance-Payment Bond (Dual Obligee), (Appendix 32), and Form FHA-2450-EH, Completion Assurance Agreement, (Appendix 33), shall be executed, except that in
lieu of Form FHA-2452-EH, the Field Office may elect to modify Form FHA-2452, Performance Bond, (Appendix 34), and Form FHA-2452-A, Payment Bond, (Appendix 35), until such time as these forms are issued with modifications appropriate to the Section 202 program.

e. The Puerto Rico statute requires the use of separate wage payment guarantee in the form of a third bond form. The form customarily used in Puerto Rico by the surety industry will be acceptable.

4571.1 REV-2

CHAPTER 7

7-11. ACCEPTABLE SURETY AND AMOUNT OF BOND.

a. Acceptable Surety. Any surety on the accredited list of the U.S. Treasury is acceptable up to the surety's bonding limit.

b. Responsibilities of Area Counsel and Area Managers. The Area Manager will determine the acceptability of the surety and the amount of the bond. The Area Counsel shall determine the legal sufficiency and form of bond and that HUD is included as an obligee on the performance-payment bond or performance and payment bonds. The latter shall also confirm with the surety firm the authority of the surety company's agent and the validity of the bond.

7-12. REQUIRED OFF-SITE IMPROVEMENTS.

a. Installation of required off-site facilities will be covered by Form FHA-2479, Off-Site Bond (which is self-explanatory), or by Form FHA-2446-EH, Escrow Agreement for Off-Site Facilities. In the latter case, the cash escrow shall be established with the depository in an interest-bearing account (at the option of the (Borrower) in an amount equal to HUD's estimate of the cost of the off-site facilities or the Borrower may furnish an unconditional, irrevocable letter of credit in favor of the Secretary, U.S. Department of Housing and Urban Development. The Area Counsel must determine that the letter of credit is legally acceptable and binding. If the Area Counsel determines that the letter of credit is acceptable, the original, together with Form FHA-2446-EH, shall be forwarded to the RAD for safekeeping until such time as advised by the Field Office as to its disposition.

b. Regardless of the form of assurance, the Area Manager will determine that it provides for completion and installation of the off-site facilities simultaneously with completion of improvements on the project site, or within a reasonable time thereafter, without cost to, or assessment against, the Borrower.
7-13. HAZARD INSURANCE REQUIREMENTS. At the initial closing the Area Manager will verify that the required hazard insurance coverage has been obtained in accordance with the Property Insurance Requirements (Appendix 28) and Form HUD-92329, Property Insurance Schedule (Appendix 29). The Area Counsel shall confirm with the surety firm as to the authority of the surety company's agent and the validity of the bond. Subsequently, certified duplicate copies of all required hazard insurance policies and the fidelity bond shall be forwarded to Program Insurance Advisory Branch, Office of Public Housing, HUD, Washington, D.C. 20410. The Forms HUD-92329 and HUD-92264, Rental Housing Project Income Analysis and Appraisal, (Firm Commitment Processing) for the project shall also be included in the transmittal. The Program Insurance Advisory Branch will examine the policies for adequacy and compliance with the required insurance coverage, approve and retain the policies. The Field Office Loan Management staff shall maintain an expiration date file for all policies and fidelity bonds and forward all such renewal policies and bonds to the Insurance Advisory Branch.

Note: On the Form HUD-92329, for any building containing a boiler, a notation shall be made stating whether it is a steam boiler or a hot water heating boiler (see Handbook 4480.1, Multifamily Underwriting Reports and Forms Catalog).

7-14. LEASEHOLDS. To be acceptable, the lease must conform to the wording of the FHA Lease Addendum, Form 2070. The terms of the lease addendum may be varied to conform to the law of the jurisdiction in which the project is located, but such changes must be approved by the Area Counsel. Any other changes have been recommended for approval by the Director, Office of Multifamily Housing Development, Headquarters.

7-15. REQUIRED MINIMUM CAPITAL INVESTMENT. A minimum capital investment of one-half of one percent (0.5%) of the total HUD-approved loan, not to exceed $10,000, is required to be escrowed with HUD or its designee at initial closing. This escrowed amount is over and above any funds which may be required for "front-end money" and capital costs (see paragraph 5-42). The minimum capital investment may take the form of a cash contribution or donation of all or a portion of the land draw available to the Borrower. Such funds shall be held during the construction period and for a three-year period beginning at initial occupancy, after which any remaining portion of the initial deposit, plus any accrued
interest, not used for operating expenses or deficits shall be returned to the Borrower. (Note: The return of accrued interest will not apply when the minimum capital investment is escrowed with HUD.) The prior approval of the Area Manager is required to use such escrowed funds. The date of initial occupancy is defined as the date the Area Manager signs the first Form FHA-2485, Permission to Occupy. This transaction may be handled as follows, at the option of the Borrower:

a. Prior to initial closing, the Borrower may establish an escrow account with a banking institution acceptable to HUD (usually a designated depository). At the option of the Borrower, the escrow may be established in an interest-bearing account, with the interest accruing to the Borrower. Letters of credit are not acceptable. At the initial closing, the Borrower must present evidence in the form of a letter from a bank officer that the required amount has been deposited for the period specified above and that such funds may not be withdrawn without prior HUD approval. The Area Counsel shall determine the acceptability of the arrangements between the bank and the Borrower. (Note: Form FHA-2476a, Escrow Agreement - Additional Contribution by Sponsors, may be modified for use in connection with the minimum capital investment.)

NOTE: 1/ If the project involves substantial rehabilitation and the rehabilitation is being done on a phased basis with some occupancy occurring immediately or scheduled to occur within less than two-thirds of the construction period, the Area Manager shall increase the escrow period, as deemed necessary.

b. The Borrower may present a check in the required amount at the initial closing payable to the U.S. Department of Housing and Urban Development. The check shall then be transmitted by the Field Office to the RAD to be held in escrow in accordance with outstanding accounting instructions.

c. The Borrower may request in a letter to the Field Office Manager/Supervisor that all or a portion of its land draw be held as undisbursed loan funds until the time initial occupancy is reached. Under this third option, Mortgage Credit shall enter such amount to be withheld from the land draw on Form HUD-92451, Financial Record of Mortgage Loan Transaction, and designate it as "Not Available During Construction." At initial occupancy, the Borrower must advise the Field Office that:

(1) They will submit a requisition and place in escrow with a local banking institution the portion of the land draw which was originally designated as the minimum capital investment, or
(2) They will submit a requisition to HUD requesting that the portion of the land draw which was originally designated at the minimum capital investment be escrowed with HUD.

7-16. ASSURANCE OF FUNDS TO MEET INITIAL OPERATING DEFICITS.

a. If an initial operating deficit is projected on Form HUD-92264, Rental Housing-Project Income Analysis and Appraisal, the Borrower or Sponsor must provide for funds to meet the projected deficit in the manner described under (1) or (2) below. Letters of credit are not acceptable.

(1) Agreement of Sponsors to Furnish Additional Funds, Form FHA-2476. This form is self-explanatory and must be accompanied by Bond Guaranteeing Sponsors’ Performance, Form FHA-2477. The amount of the bond must equal the sum required to be deposited in Form FHA-2476. On or before the date specified in Form FHA-2476, the Borrower or Sponsor shall place the required funds in escrow and shall furnish an Escrow Agreement - Additional Contribution by Sponsors, Form FHA-2476a, showing the deposit of cash or United States bearer bonds at market value.

b. The foregoing requirements concerning funding of a projected operating deficit shall not be waived, in whole or in part, without the prior written approval of the Director, Office of Multifamily Housing Development. The Area Manager shall assure that funds provided under subparagraphs a(1) or (2), above, are utilized prior to authorizing use of the minimum capital investment.

7-17. COLLATERAL AGREEMENTS. If any collateral agreements are necessary with respect to any unusual conditions encountered at initial closing, executed duplicate copies of any documents in connection therewith must be submitted by the Borrower. The Area Counsel shall determine the acceptability of any collateral agreements prior to disbursing any loan funds.

7-18. BORROWER'S ATTORNEY'S OPINION. At closing, the Borrower's attorney must submit a comprehensive opinion, addressed to HUD, as to the legality and adequacy of the contractual instruments.

*7-19. FIDELITY BOND DURING CONSTRUCTION PERIOD.
a. Basic Requirement. The Borrower shall purchase a Blanket Fidelity Bond covering all officials and employees based upon an amount equal to the average anticipated loan disbursements during the construction period. The minimum limit shall be determined by dividing the total mortgage amount by the estimated number of months in the construction period plus 2 and rounding the quotient to the nearest $50,000. Under no circumstances should a bond exceed $500,000.

b. Exceptions. Projects using modular components and projects for which the average loan disbursements are expected to exceed $500,000 shall establish an escrow with a title company to handle all disbursements during the course of construction. In cases where a title company is utilized, no fidelity bond is required for the Borrower until the project enters the operating period. Funds normally in the loan to cover fidelity bond during construction may be utilized to the extent necessary to pay the fee charged by the title company.
7-24. PRE-CONSTRUCTION CONFERENCE. A pre-construction conference shall be held prior to the start of construction, at which time labor standards, prevailing wage procedures, and HUD's policy on equal employment shall be outlined.

a. Housing Director must read and explain Form FHA-2554, Supplementary Conditions of the Contract for Construction. This form sets forth the pertinent obligations which are assumed by a contractor or subcontractor performing under a covered contract, as well as a statement of the sanctions that may be applied in the event of non-compliance. A copy of Form FHA-2554, Supplementary Conditions of the Contract for Construction, is to be made part of all contracts entered into with a subcontractor. Each contractor should be given additional copies to pass on to any subcontractors not present.

b. Copies of the Equal Opportunity Poster will be given to the contractors and subcontractors present. Each contractor and subcontractor must agree to put these posters in conspicuous places available to employees and applicants for employment. Additional copies of the poster will be furnished each general contractor. The additional copies will be provided for any subcontractors not present.

7-25. COMMENCEMENT OF CONSTRUCTION. Construction must not Commence before formal closing and recordation of the mortgage except with the prior approval of the Area Manager. In no case will permission be given to start construction prior to issuance of a Firm Commitment.

a. When a Firm Commitment has been issued, and when the Area Manager is satisfied that there are valid reasons why an immediate closing is not practicable, that there is every reasonable assurance that closing will take place in the near future, and the Area Counsel is satisfied that an "early start" will not act to the detriment of the Secretary's interest, permission to start may be granted by execution of Form FHA-2415 provided the Form has been executed by general contractor and Borrower without additions, deletions or alterations of any kind.

b. Permission to start will not be granted in any case where final drawings and specifications have not been filed with and approved by HUD.