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# Mortgage Credit Underwriting and Processing Requirements

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## 8.1

### Qualifications and Duties

#### A. Lender Qualifications

1. The Lender's underwriter must have basic knowledge and skills in a variety of financial areas, including:
  - a. General experience in banking, accounting, finance, or commercial lending, and in multifamily mortgage financing.
  - b. The ability to analyze corporate financial statements including, but not limited to, balance sheets, income statements, and statements of changes in financial position, and to evaluate the credit acceptability of individuals, partnerships, corporations, and other entities.
  - c. A broad knowledge of lending practices for mortgages and construction loans and the financial structures of individuals, partnerships, and other entities.

#### B. Major Duties and Responsibilities of the Lender's Underwriter

1. The underwriter serves as a member of the Lender's processing team, calling for specific requirements and terms in the preparation of underwriting recommendations to HUD. The duties and responsibilities are divided into two phases. The first phase involves application underwriting and the second phase relates to the construction period.
  - a. Duties and responsibilities associated with the application underwriting are as follows:
    - (1) Makes a determination of the acceptability of the general contractor, the sponsor, the mortgagor, if formed, and its key principals through a thorough analysis of their credit, character, financial condition, motivation for ownership, availability of assets for closing and adequacy of income for total obligations.
    - (2) Uses trade references, bank references, credit data and construction experience resumes in analyzing the construction capability of the general contractor including financial stability, and ability to complete the project.

- (3) Determines the recommended maximum mortgage amount and other key terms of the loan.
- b. Duties and responsibilities during the construction period are:
  - (1) Initial distribution of mortgage proceeds into various accounts and maintains a record of control and disbursement thereafter. This includes the preparation of Form HUD 2283, Financial Requirements for Closing, based on information contained in the Firm Commitment and approved closing documents.
  - (2) Determines construction cost (as approved by the HUD inspector), architect fees and carrying charges payable under request for advances of multifamily mortgage proceeds, preparing written reasons for modification as necessary.
  - (3) Recommends approval of construction change orders and recommends release of both on-site and off-site escrow funds, citing special requirements or conditions of approval as necessary.

### C. Major Duties and Responsibilities of HUD

1. HUD is to perform the following major mortgage credit functions during the application underwriting and construction periods.
  - a. During application underwriting:
    - (1) Reviews the Lender's mortgage credit report(s) regarding the acceptability of the sponsor, mortgagor, and its key principals, and the contractor.
    - (2) Performs HUD 2530 Clearance Process.
    - (3) Determines the maximum mortgage amount and other key terms of the loan.
    - (4) Determines actual financial settlement requirements.
    - (5) Reviews initial and final closing documents for compliance and acceptability
  - b. During the construction period:
    - (1) Reviews and approves the Lender's proposed initial distribution of mortgage proceeds.
    - (2) Approves construction change orders.
    - (3) Reviews the mortgagor's cost certification based on HUD allowed costs.
    - (4) Determines the final maximum insurable mortgage.
    - (5) Reviews and approves the final distribution of mortgage proceeds.

## 8.2

## Pre-application Processing

### A. Exhibits

1. HUD-92013 Application for Multi-Family Housing Project
  2. HUD-3433, Request for Preliminary Determination as Nonprofit Sponsor and/or Mortgagor and supplemental documentation
- B. Mortgage Credit Duties and Responsibilities of the Lender's Underwriter
1. Determines general and financial acceptability of any proposed nonprofit sponsor/mortgagor in accordance with Section 8.12.
- C. Duties of HUD
1. Makes final determination of acceptability of any nonprofit sponsors/mortgagors.

### 8.3

## Firm Commitment Processing – Determining Acceptability of the Borrower and General Contractor

### A. In General

A key component of the underwriting process is to assess the mortgagor's ability to manage the development, construction, completion, and successful lease-up of the property. The underwriting of multifamily and healthcare projects involves evaluating the character, ability and financial condition of the sponsor, mortgagor, its key principals, and the general contractor. The Lender's underwriter must:

1. Identify the mortgagor and its principal or key individuals.
2. Analyze the credit worthiness of the principal sponsors, the mortgagor entity, if formed, and the contractor.
3. Analyze the mortgagor and contractors experience record.
4. Determine the financial capability of the mortgagor and the general contractor.
5. Evidence specific experience (within the previous 5 years) in underwriting the development and operation/management of health care facilities.

### B. Exhibits

1. Data in the Application Multifamily Projects, Form HUD-92013 disclosing:
  - a. Type of mortgagor entity.
  - b. Interest rate, costs of issuance (if the project will be financed with tax-exempt or taxable bonds), financing fees and discounts to be charged.
  - c. Names, addresses, telephone numbers and Social Security Numbers (SSN) or Employer Identification Numbers (EIN) for the sponsor, mortgagor, if formed, general contractor, attorney, architect and consultant, if any. NOTE: Providing the SSN/EIN is mandatory for the sponsor, mortgagor and their principals; however, this information is voluntary for all other participants.

- d. Sources of funds for the mortgagor entity.
2. Current resumes of the sponsor, mortgagor and its key principals, and the general contractor.
3. Form HUD-2530, Previous Participation Certification, for all parties identified on Page 1 of the Instructions for Completing the Previous Participation Certificate, Form HUD-2530.
4. Form HUD-92013 Supp, listing bank and trade references for all sponsors, the mortgagor, each principal of the mortgagor, and the general contractor along with disclosure of prior legal action, outstanding delinquent Federal debt, and SSN or EIN, whichever is applicable.
5. A verification of deposit, for each bank reference included on Form HUD-92013 Supp.
6. Grant and/or Loan Commitment letter (if applicable).
7. A listing from all sponsors, the mortgagor, all principals of the mortgagor entity and the general contractor of all business concerns in which these entities serve as a:
  - a. general partner;
  - b. limited partner with a 25 percent or more interest;
  - c. stockholder with a 10 percent or more interest; or
  - d. corporate officer.
8. A statement whether an identity of interest exists between the mortgagor and the general contractor, and/or architect.
9. Credit reports, current within 30 days of the application date.
10. Evidence of site control (valid option, purchase agreement or documentation proving ownership) and the date of the last arms-length transaction and price.
11. Certifications from the sponsor, the mortgagor entity, each principal and the general contractor which authorize the release of banking and credit information. A certification similar to the following is required:

"To Whom It May Concern:

Please be advised that the undersigned, as (mortgagor/a principal sponsor/general contractor), hereby consents to the release of any banking and credit information in connection with the loan application for the construction of \_\_\_\_\_ (project name) \_\_\_\_\_ to the \_\_\_\_\_, Mortgagee, U.S. Department of Housing and Urban Development, and Delegated Processor or any Technical Discipline Contractor contracted by HUD to process this application.

By: \_\_\_\_\_

Date \_\_\_\_\_"

### C. Identifying the Borrower and Its Principals

1. There are numerous ways for investors to own an interest in real property. Each of these different forms of ownership provides the investor with different capabilities and limitations in making a profit from the property. No particular form is necessarily ideal; each has certain advantages and disadvantages. Depending on the property and the goals of the investors, one form can be more beneficial than others. Each form has different effects on income from the property, payment to the investor, tax obligations, and the relationship between the manager and the owner. Identifying the form of ownership helps the underwriter in determining who the likely principals will be in a specific borrower entity.
2. Principal forms of Property Ownership are:
  - a. sole proprietor;
  - b. general partnership;
  - c. limited partnership;
  - d. corporation, C corporation, S corporation;
  - e. limited liability company; and
  - f. trusts.

NOTE: Any combination of ownership forms can be used to establish a joint venture. The purpose is to jointly share the risks and the rewards by contributing the appropriate knowledge, skills or assets that are necessary.

### D. Identifying the Principals

1. Pursuant to 24 CFR Section 200.215(e)(1), a principal is a public or private entity proposing to participate in a project as a sponsor, owner, prime contractor, nursing home administrator or operator, etc. The principal's role can be one of actual participation in directing the activities and affairs of the mortgagor entity or involvement in decision making, or one of inactive participation where an ownership interest has been acquired. All principals must be identified and analyzed based on their credit, experience, and financial histories.
  - a. Who is a "Principal"
    - (1) Sponsors and owners of the project: Principals of the mortgagor including all general partners, limited partners with a 25 percent or more interest, stockholders (in the case of corporations) or members (in the case of limited liability corporations) with a 10 percent or more interest, and operating officers of the corporation;
    - (2) General contractors;
    - (3) (3) Management agents;
    - (4) Packagers, consultants and other persons or organizations hired: to furnish advisory services in project financing, construction or operation; select and

negotiate contracts with contractors, architects, attorney or managing agents; secure financing; or meet HUD requirements; and

- (5) Architects and attorneys who have any interest in the project other than an arms-length fee arrangement for services.

Note: Financial and credit analysis are not required unless they meet the sponsor and owner criteria in 8.3.D.(1) above.

- b. Who is not a “Principal” (Form HUD-2530 is not required for:)

- (1) Stockholders with less than 10 percent interest in a corporation;
- (2) Limited partners with less than 25 percent interest in the partnership;
- (3) Attorneys and architects with only an arms-length fee arrangement for services;
- (4) Minor corporate officers; and
- (5) Sub-contractors.

#### E. The Credit Investigation

1. Lenders require credit reports or credit histories as a means of validating and cross checking information received from the borrower in the financial statements and application forms.
2. Credit reports give a picture of the borrower’s payment history and financial interactions with its creditors and allow the underwriter to make sound conclusions about the borrower’s credit worthiness. They also allow the Lender to reconcile any significant contradictions between the financial statements and the credit report.
3. A commercial credit report for business or a residential mortgage credit report (RMCR) for individuals current within 30 days of the application acceptance date is required on:
  - a. All Sponsors;
  - b. The mortgagor entity, if formed before submission of application;
  - c. Principals of the mortgagor defined in D.1.a.(1):

NOTE: If a principal is a business entity (i.e. corporation, partnership) with an operating history, a credit report will be required only on the business firm not the owners of the firm.
4. Business concerns listed in Section 8.3.B.7 require credit reports on:
  - a. All businesses involving a pending judgment(s), legal action or suit or bankruptcy claim;

- b. A 10 percent statistical sampling selected by the mortgagee up to a maximum of 10 or any remaining ventures.
5. The general contractor.
6. The housing consultant, as applicable for nonprofit transactions.

#### F. Lender's Review of the Credit Report

1. It is important that all information obtained from credit reports and histories be compared to the financial statements provided by the relevant borrower or principal(s). Any contradictory issues should be the subject of further inquiry until the evidence shows a consistent and complete picture.
2. Make reasonable inquiries to determine if the applicant or any principal is in default on any Federal debt, i.e., direct loans, HUD insured loans, student loans, Small Business Administration loans, or judgment liens against property for a debt owed the Federal government.
3. Determine if discrepancies exist between the information included on the financial statement and in the credit report.
4. Investigate any adverse credit information that appears on the credit report or which becomes known because of making inquiries of bank and trade references and other HUD offices. Require a written explanation of any late payments, actions, judgments or derogatory information.

#### G. Delinquent Federal Debt:

1. When a delinquent Federal debt exists, the Lender shall include as part of the required application exhibits:
  - a. A detailed written explanation from any applicant or principal with a prior Federal default or claim or whose credit report and financial statements contain conflicting or adverse information.
  - b. A letter from the affected agency, or agency letterhead and signed by an officer, stating the delinquent Federal debt is current or satisfactory arrangements for repayments have been made.
  - c. The Lender's reason(s) for recommendation of the applicant, which may be included in the Lender's report as described in Section 8.9.

#### H. Trade and Credit References

1. Review Form HUD-2530, Previous Participation Certification, for the principal's prior experience with HUD and approval to participate in the proposed transaction. In addition to the credit report, make inquiries of banks and trade references that have been disclosed on the HUD-92013 Supp.

2. For bank inquiries, rely on the completed Forms HUD-92004-F, Request for Verification of Deposit. Obtain verification of deposit for each bank reference listed on HUD-92013 Supp and the participant's financial statements.
  3. Written inquiries of trade references should include a copy of the certification authorizing the release of credit information.
  4. Do not require verifications of deposit on officers of a nonprofit corporation and officers of a profit-motivated corporation that have no ownership interest in the corporation and are not being relied upon for financial capacity. However, a general written inquiry to the bank about their experience with the individual/firm is required.
- I. Rejection Because of Unacceptable Credit:
1. Consider the individual/firm a credit reject if:
    - a. The credit investigation evidences that the principal has a history of not repaying creditors in a timely manner.
    - b. Delinquent Federal debt has not been resolved or satisfactory arrangements made for repayment.
    - c. There are judgments or actions against the party which:
      - (1) Could significantly impact upon the financial position of the individual firm.
      - (2) Result in a determination that the individual/firm is an unacceptable credit risk.
- J. Analyzing the Borrower's and Contractor's Previous Experience:
1. The Lender's underwriter is to evaluate the resume of the principal(s). In doing so, the underwriter will be looking for their experience in developing, owning or building similar multifamily properties. Pay particular attention to:
    - a. type and size of previous projects;
    - b. geographic area of business involvement;
    - c. length of time served in this capacity; and
    - d. past roles in multifamily business.
  2. Each resume should demonstrate the level of experience needed to successfully complete the development of the project.
  3. Require the addition of members to the development team if necessary to satisfy experience requirements.

## 8.4

## Firm Commitment Processing Financial Statements

### A. Introduction

1. Financial statements give a picture of the financial position of an individual/company at a point in time and provide historical information for measuring and evaluating the financial performance of a principal/firm and provide advance warning of financial problems.
2. Use this information to determine if the sponsors, the mortgagor and/or the principals of the mortgagor have the financial capacity to develop, build and complete the project and whether the general contractor has the ability to deliver the project based on:
  - a. past financial condition;
  - b. present liquidity; and
  - c. projecting future financial capacity.
3. Complete the financial analysis with the objective of determining the amounts available for investment in the project by performing an analysis of working capital. Working capital is the difference between current assets and current liabilities. It is used to purchase assets, pay off debt and make up deficits from operations. The financial analysis also determines which nonpledged, unsecured assets can be readily hypothecated to produce the required investment.

#### B. Exhibits

The sponsor, mortgagor, (if fully capitalized), and general contractor must furnish current financial statements with supporting schedules as part of the application for commitment processing.

1. Individuals must submit either:
  - a. Personal Financial and Credit Statement, Form HUD-92417:
    - (1) For married sponsors or principals, the form must also be signed by the spouse.
    - (2) If a spouse's signature cannot be obtained, the principal must prepare the form reflecting only those assets that are solely in their name and any liability, including those joint liabilities, for which they have any responsibility.
  - b. A substitute statement, which contains at a minimum the information contained on Form HUD-92417. This form must contain the following certification and criminal warning:
    - (1) I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the mortgagor [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of \_\_\_\_\_'s (Name of mortgagor or owner) as of \_\_\_\_\_ (date of financial statement).
    - (2) Signed this \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_ Signature of authorized agent with name printed or typed under signature \_\_\_\_\_.
    - (3) Warning – HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)

For married individuals, certification also must be signed by the spouse.

2. Business entities must submit the following separate statements and supporting documents for the last 3 years or the length of existence, if less than 3 years, signed and dated by an authorized officer of the organization.
  - a. Balance Sheet which:
    - (1) provides a breakdown of current and noncurrent assets and liabilities;
    - (2) identifies restricted and nonrestricted funds; and
    - (3) identifies the current portion of long-term debt.
  - b. Income and Expense Statement which reflects:
    - (1) income from normal operations;
    - (2) investment income;
    - (3) other income; and
    - (4) total expenses.
  - c. If the financial statements are audited, a Statement of Changes in Financial Position or if a fund accounting system is used, a Statement of Changes in Fund Balance, and all notes.
  - d. Supporting Schedules:
    - (1) An Aging Schedule of Accounts Receivable that provides the name, type of account (trade, affiliate, employee, relative or other), payment terms, amount and aging information.
    - (2) An Aging Schedule of Notes Receivable that provides the name, type of account, payment terms, maturity date, current portion (due within 1 year or one operating cycle of the business, whichever is less), past due amounts and non-current amount.
    - (3) Schedule of Pledged Assets, if applicable. Identify the pledged asset, the amount pledged and the offsetting liability.
    - (4) Schedule of Marketable Securities that provides: name, number of shares, current market values of the date of the statement, and exchange where listed.
    - (5) Schedule of Accounts Payable that provides: name, type of account (trade, affiliate, employee, relative or other), payment terms, amount and aging information.
    - (6) Schedule of Notes and Mortgages Payable that provides: name, type of account, payment terms, maturity date, current portion (due within 1 year or one operating cycle of the business, whichever is less), past due amounts and noncurrent amount.
    - (7) Schedule of Legal Proceedings, if applicable.
    - (8) In addition to the applicable schedules in above paragraphs, general contracting firms must submit a schedule of jobs (work) in progress that identifies:
      - (a) original contract price;

- (b) construction start date;
  - (c) construction completion date; and
  - (d) percentage of completion.
  - e. Combined or consolidated statement(s), if applicable,
  - f. Other financial data necessary to determine the financial responsibility and capacity of the sponsorship or general contractor,
  - g. The certification, signed and dated by an authorized official of the company, or truth and accuracy and the criminal certification. The certifications must reference the name of the business and the date of the financial statement(s).
3. Section 223(f) Project Financial Statements.

The proposed mortgagor must submit the last three fiscal years financial statements on the facility and if more than three months have expired since the closing date of the financial statements, a year-to-date balance sheet and operating statement.

a. Audited Financial Statements.

The latest year's financial statements should be audited by a CPA or IPA. However, if the project owner does not maintain audited financial statements, an owner-certified financial statement for the latest year is acceptable. (See item c. below.)

b. There may be circumstances beyond the mortgagor's control where the required financial statements are not available.

(1) The mortgagor must submit:

- (a) Evidence satisfactory to the Lender that the financial statements are not obtainable; and
- (b) The project financial statements that are available including an owner-certified balance sheet and operating statement. (See item c. below.)

(2) Lender's case file must contain a statement from the mortgagor that explains why all the required records are not obtainable and a memorandum from the underwriter to the Hub or Program Center Director stating that he/she has evaluated the mortgagor's statement and agrees that the information is not available.

c. Any owner-certified financial statement or owner-certified balance sheet and operating statement must include certification and criminal warning found in 8.4 B.1.b. above.

Note: For Section 232 pursuant to Section 223(f) the mortgagor must submit Medicare and Medicaid Cost Reports for the last three years

### C. Processing for Financial Statements

1. A current financial statement must be no more than 3 months old when Form HUD-92013 is submitted to the Lender for Firm Commitment review. Exceptions:
  - a. The credit investigation or other circumstances may warrant more current financial statements.
  - b. Audited financial statements prepared by an independent Certified Public Accountant or a Public Accountant may be up to a year old. The audited statements must be supplemented with updated interim financial statements, which may be management prepared, if more than six months have lapsed since the closing date of the audited statement.
2. A mortgagor entity with adequate capital does not require financial statements of the individual ownership interest(s). The mortgagor entity must be fully funded in an account in the name of the mortgagor entity.
3. A working capital determination is to be made by the Lender's underwriter for the mortgagor and the general contractor from a review of the financial statements. Working capital is the excess of current assets over current liabilities. The net working capital is to be adjusted for the effects of contingent liabilities and the financial needs of other projects in the planning stage or under construction adjusted by the percentage of completion.
4. Net worth in lieu of working capital: When fixed assets could secure loans to cover the project's financial requirements, recommend approval based on "true net worth" rather than on working capital.
  - a. Require the principal to provide a commitment letter from a lending institution, which states:
    - (1) The rate, amount, term and conditions, if any, of the loan that the lending institution is willing to provide.
    - (2) The date by which the commitment letter must be exercised. (Must extend at least to the anticipated date for initial endorsement).
    - (3) The party that will be responsible for repayment of the loan, if the commitment is exercised.
      - (a) Repayment may not be an obligation of the mortgagor entity.
      - (b) A certification indicating that the lending institution will not make any claim against the mortgaged property, mortgage proceeds, any reserve or deposit required by HUD, or against the rents or other income from the mortgaged property for payment of the loan. This certification must contain the criminal certification.
5. Funds provided by a Parent Company or Affiliate of the Sponsor: Require a certification from the Board of Directors or authorized agent that specifies the funds the parent company/affiliate is willing to commit.
  - a. Establish the availability of funds from parent company/affiliate. Consider whether:
    - (1) Individual corporations have any operating capital to spare.

- (2) Laws under which they are incorporated or their banks permit:
  - (a) Withdrawals, loans or advances to owners or sponsors.
  - (b) Stock investment in affiliated corporations.
  - (c) Guarantee of debts of associated corporations.
6. Letters of intent and letters of credit cannot be used to establish financial capability. At initial endorsement, letters of credit may be substituted for cash to set up many of the escrows required at initial and final endorsement, or during construction. If a sponsor draws down cash at initial closing to satisfy escrow requirements, a letter of credit cannot be substituted to establish the same escrow requirements. When a letter of credit is permitted, it must always be:
  - a. Unconditional and irrevocable;
  - b. Issued by a banking institution; and
  - c. Valid and collectible.
7. The Lender of record may not be the issuer of any letter of credit without prior written consent of the Hub Director. If a demand under any letter of credit is not met immediately, the Lender must provide the cash equivalent to the undrawn balance under the letter of credit.
8. Lines of Credit: Existing lines of credit may be used to establish financial capability. With the Firm Commitment application, require the principal to provide a letter from a lending institution that confirms:
  - a. The existence of the line of credit, original amount and available balance, repayment terms, and expiration date.
  - b. The line of credit expiration date cannot occur prior to project completion.
9. Sponsor's Continuing Commitments
  - a. A written statement must be submitted from principals who are sponsors indicating the parameters of their financial commitment to and contractual relationship(s) with the mortgagor:
    - (1) If the relationship is not intended to continue until the project reaches sustaining occupancy, the financial requirements have not been met.
    - (2) Any sponsor not having an ownership interest in the mortgagor entity must also certify in writing the amount it is willing to commit.
  - b. The HUD Firm Commitment will contain special conditions to ensure the contractual association of the sponsor to the project:
    - (1) The condition must indicate that the withdrawal of any individual/firm relied on for financial capacity requires prior HUD approval.

- (2) Identify the individuals/firms relied on for financial capacity. For confidentiality reasons, do not indicate their alphabetic designation or their dollar contribution listed on Form HUD-92264-A.
    - (3) Indicate that the withdrawal of any individual/firm relied on for financial capacity could result in HUD declaring the commitment null and void.
  - c. Require closing documentation, i.e., organizational documents, reflecting such continuing contractual relationships.
  - d. If there is a change in sponsorship of the individuals/firms relied on for financial capacity and the remaining principals do not demonstrate the capacity to meet the financial requirements of the project:
    - (1) At any stage through Firm Commitment, this is considered a significant deviation from the original concept and generally cause for rejection of an application.
    - (2) After the issuance of the Firm Commitment, but before initial endorsement occurs, this is considered a significant derivation from the application for which the commitment was issued and may be cause for declaring the Firm Commitment null and void.
10. Individuals are prohibited from submitting financial statements as a sponsor and then abandoning the project and the mortgagor after the Firm Commitment is issued.
11. The submission of a financial statement that is used to influence Federal Officials concerning a mortgage insurance risk determination when the sponsor does not plan a continuing relationship with the mortgagor could result in appropriate sanctions being taken against the sponsor (e.g., suspension, debarment).
12. General Contractor with Adequate Capital: The general contractor's adjusted working capital position should equal 5 percent of the estimated construction contract.
  - a. The instructions for hypothecation of fixed assets may be applied if the general contractor does not have an acceptable working capital position.
  - b. The general contractor's ability to obtain a performance-payment bond does not negate or lessen this requirement.
  - c. Adjust the working capital for projects underway.
  - d. If the general contractor does not have an acceptable working capital position or sufficient fixed assets that can be hypothecated, a joint venture may be established with a financially stronger general contractor provided these firms' combined working capital equals at least 5 percent of all construction contract amounts for projects in construction and development.
13. In the case of Low Income Housing Tax Credit transactions, the application may include a Letter of Commitment to fund the required equity from a tax credit syndicator or investor. This Letter of Commitment must specify the amount, pay-in schedule and other matters so that HUD and the Lender can ensure sufficient equity in a manner which

meets HUD's other requirements. The Lender underwriting the loan will also make the determination to require additional documentation (e.g. financial statements, etc.).

## 8.5

### Term of Mortgage and Commencement of Amortization

- A. For Sections 220, 221(d)(3), 221(d)(4) and 232 projects:
1. The term of the mortgage is the lesser of 75% of the estimated remaining economic life of the physical improvements or 40 years from the date of the first payment to principal.
    - a. The mortgage term must be in whole years.
    - c. Disregard any fraction of a year.
  2. Amortization starts:
    - a. For Insurance of Advances projects, no later than 4 months after the date of construction completion.
    - b. For Insurance of Completion project, the first day of the second month following the date of final endorsement.
- B. For Section 207 pursuant to 223(f) projects and Section 232 pursuant to 223(f) projects:
1. The term of the mortgage shall not be less than 10 years, nor shall it exceed the lesser of 35 years or 75 percent of the estimated remaining economic life of the physical improvements.
    - a. The mortgage term shall be the eligible number of whole years between 10 and 35.
    - b. Disregard any fraction of a year
  2. Amortization starts on the first day of the second month following the date of the initial/final endorsement of the mortgage for insurance.

## 8.6

### Additional Firm Commitment Processing Exhibits

- A. For Sections 220, 221(d)(3), 221(d)(4) and 207 pursuant to 223(f) projects:
1. HUD-92013, Application for Multifamily Housing Project
  2. HUD-92264, Rental Housing Project Income Analysis and Appraisal
  3. HUD-92264-A, Supplement to Project Analysis
- B. For Section 232 and 232 pursuant to 223(f) projects:
1. HUD-92013, Application for Multifamily Housing Project
  2. HUD-92264 (NHICF), Project Income Analysis and Appraisal - Nursing Homes - Intermediate Care Facilities and Board and Care Homes

3. HUD-92264-A, Supplement to Project Analysis
4. HUD-3434, Certificate of Relationships and Nonprofit Motives
5. HUD-3435, Certificate of Contractual Relationship

**8.7**

### **Sections 220 and 221(d) Firm Commitment Processing - Determining Mortgage Amounts, Cash Requirements, and Related Items**

#### A. Firm Commitment Processing.

1. Amount of loan for new construction includes construction of all types of projects not involving substantial rehabilitation. The insurable amount is the lowest of:
  - a. Application amount.
  - b. The result of Lender's estimate of the replacement cost after completion, less the amount of grant/loan funds attributable to replacement cost items, multiplied by the applicable percentage.

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
221(d)(3)	Nonprofit	100
221(d)(4)	All Mortgagors	90
220	All Mortgagors	90

- c. An amount attributable to dwelling use, excluding exterior land improvements, not to exceed:
  - (1) For walk-up structures:
    - (a) Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3), the per family unit limits in Appendix 8B.
    - (b) Projects involving eligible mortgagors to be insured under Section 221(d)(4), the per family unit limits in Appendix 8B.
    - (c) Projects involving eligible mortgagors to be insured under Section 220, the per family unit limits in Appendix 8B.
  - (2) For elevator type structures:
    - (a) Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3), the per family unit limits in Appendix 8B.
    - (b) Projects involving eligible mortgagors to be insured under Section 221(d)(4), the per family unit limits in Appendix 8B.
    - (c) Projects involving eligible mortgagors to be insured under Section 220 the per family unit limits in Appendix 8B.
  - (3) Per family unit limits may be increased by:

- (a) The approved High Cost Percentage (HCP) for the jurisdiction in which the project will be located.
  - (b) A percentage above the approved HCP up to 140 percent maximum, which results in a maximum of 240 percent of the base per family unit limits. Hub Directors in the project jurisdiction may exercise their waiver authority on a case-by-case basis to increase the HCP.
  - (c) The limits for walk-up and elevator structures may be increased by up to 20 percent, if necessary, for purchase and installation of a qualified solar energy system. This is in addition to any increase in a high cost area.
  - (d) If the Commissioner finds good cause in Alaska, Guam, or Hawaii, the maximum, high cost percentage may be increased by up to one-half.
- (4) The amounts in (3) may be increased by the percentage of the site not attributable and cost not attributable to dwelling use, including exterior land improvements.

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
221(d)(3)	Nonprofit	100
221(d)(4)	All Mortgagors	90
220	All Mortgagors	90

- d. Debt service that does not exceed the applicable percentage of projects' estimated net income.

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
221(d)(3)	Nonprofit	95
221(d)(4)	All Mortgagors	90
220	All Mortgagors	90

The mortgage may exceed this limit by capitalizing the savings from any tax abatement. In such cases the net earnings estimate will not reflect that temporary tax abatement.

- (1) That portion of the maximum mortgage supported by the tax abatement must be amortized over the life of the abatement.
  - (2) The Tax Abatement must run with the real estate and not with the type of sponsorship.
2. Amount of Loan - Rehabilitation. (This includes only projects involving substantial rehabilitation or reconstruction.) The insurable amount is the lowest of:
- a. Amounts in paragraph 8.7 A.1., except b.
  - b. The result of the Lender's cost estimate of rehabilitation and fair market value of the land and existing improvements before rehabilitation, less the amount of grant/loan funds attributable to replacement cost items, multiplied by the applicable percentage.

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
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221(d)(3)	Nonprofits	100
221(d)(4)	All Mortgagors	90
220	All Mortgagors	90

B. Insurance of Advances.

See Chapter 13 for processing instructions.

## 8.8

### Section 232 Mortgage Amounts, Cash Requirements, and Related Items

A. Firm Commitment Processing for Section 232

1. Amount of Loan - New Construction:

Includes construction of all types of projects not involving substantial rehabilitation. The insurable amount is the lowest of:

a. Application Amount.

b. Value Amount.

(1) Proprietary Mortgagor. Ninety percent of result of the Lender's estimate of value including major movables less the amount of grant/loan funds attributable to replacement cost items.

(2) Nonprofit Mortgagor. Ninety-five percent of Lender's estimate of value including major movables.

Do not deduct that portion of grant/loan funds attributable to replacement cost items. Instead complete loan criteria d below.

c. Debt service that doesn't exceed 90 percent for proprietary mortgagor, 95 percent for nonprofit mortgagor of the project's estimate net earnings attributable to realty and nonrealty (excluding proprietary earnings, line 6, Section G., Form HUD-92264, NHICF). The mortgage may exceed this limit by capitalizing the savings from any tax abatement. In such cases the net earnings estimate will not reflect that temporary tax abatement.

(1) That portion of the maximum mortgage supported by the tax abatement must be amortized over the life of the abatement.

(2) Tax Abatement must run with the real estate and not with the type of sponsorship.

d. Replacement cost less grants, loans, and gifts. This criterion only applies to nonprofit mortgagors.

2. Amount of Loan - Rehabilitation:

This includes only projects involving substantial rehabilitation or reconstruction and additions and improvements where the existing facility is involved in rehabilitation. The insured loan must be the lesser of:

- a. Amounts in paragraph 8.8 A.1.
- b. Property held in fee - One hundred percent of the estimated cost of rehabilitation less grant/loan funds attributable to replacement costs items.
- c. Property subject to existing mortgage - Lender's estimated cost of rehabilitation, reduced by grant/loan funds attributable to replacement cost items plus the lesser of:
  - (1) Secured indebtedness, or
  - (2) Ninety percent (95 percent for nonprofit mortgagors) of the sum of Lender's estimate of the Fair Market (As-Is) Value of the property before rehabilitation less:
    - (a) The value of the leased fee, if leasehold, and
    - (b) The amount of non-pre-payable special assessments.

Note: Investigate any recent debt placed against the property. Exclude from the mortgage computation any debt that was created to increase the existing indebtedness in an attempt to circumvent this mortgage criterion.

Note: HUD defines "recent indebtedness" as any debt incurred up to one year before application for mortgage insurance is made.

Debt incurred by the operator is not mortgageable. If the debt is secured by the health care facility, the lien must be removed at the time of initial/final endorsement.

Process a property acquired after the initial application as property to be acquired.

- d. Property to be acquired - Ninety percent (95 percent for nonprofit mortgagors) of the sum of Lender's estimated cost of rehabilitation after subtracting grant/loan funds attributable to replacement cost items plus the lesser of:
  - (1) Ninety percent (95 percent for nonprofit mortgagors) of the actual purchase price of the property,
  - (2) Ninety percent (95 percent for nonprofit mortgagors) of the sum of Lender's estimate of the Fair Market (As-Is) Value of the property before rehabilitation less"
    - (a) The value of the leased fee, if leasehold and
    - (b) The amount of nonprepayable special assessments.

Note: If an identity of interest exists, regardless of how slight, between the seller of the property and the sponsor, the transaction must be considered a refinancing transaction rather than a purchase transaction.

**B. Existing Facility with an Addition [AKA] Blended Rate Processing for Section 232****A. Overview.**

HUD permits an existing health care facility that does not require rehabilitation, only repairs, to be refinanced or purchased and for the transaction to include the construction of an addition.

1. Process the transaction using "blended rate" underwriting requirements below. These requirements blend together Section 232 New Construction and Section 232 pursuant to 223(f) Existing underwriting instructions contained in this Notice.

2. At initial endorsement:

a. Release the monies for the:

(1) Addition under the insurance of advances procedure.

b. A large portion of the loan is represented by an existing facility that is operational and self supporting at the permanent loan interest rate.

(1) The underwriting for the existing facility will not provide construction loan interest funds.

(2) If the construction loan interest rate is higher than the permanent interest rate the appraiser will determine the amount of an interest rate shortfall escrow.

a. The escrow must cover the additional interest charges for the estimated construction period plus an additional 6 months.

b. The mortgagor must fund the interest shortfall escrow at initial endorsement.

Note: If a nonidentity of interest operator of a health care facility has financed improvements to the facility with debt, the cost of these improvements were performed as a result of a business decision and are NOT eligible to be included in the purchase transaction.

3. Amortization Period of the Mortgage.

The maximum term of the mortgage will not exceed 75 percent of the remaining economic life of the existing health care facility or 35 years, whichever is less.

**B. Form 92264-HCF, Health Care Facility Summary Appraisal Report.**

1. Prepare two HUD Forms 92264-HCF: one for the existing facility; and one for the addition.

a. The A & E/Cost processor:

1) Completes the sections of a 92264-HCF for the existing facility and a 92264-HCF for the new addition; and

2) Prepares two cost analyses: one for the required repairs, if any, on the existing facility and one for the new addition.

**Note:** *Davis Bacon prevailing wage rates apply on new construction additions and when developing the estimated repair cost on the existing facility.*

b. Valuation:

- 1) Completes two 92264-HCF Forms, one for the existing facility and one for the new addition following instructions as modified by this Notice; and
- 2) Establishes the amount of the interest shortfall escrow, if required and records the amount in Section L, "Remarks," of 92264-HCF.

2. Form HUD 92264-A, Supplement to Project Analysis.

The mortgage credit examiner prepares three HUD 92264-A's,

- a. A Form HUD-92264-A for the existing facility based on instructions for computing the maximum insurable mortgage and the total requirements for settlement under Section 232 pursuant to 223(f)
- b. A Form HUD-92264-A for the addition based on instructions for computing the maximum insurable mortgage and the total requirements for settlement under Section 232 for New Construction.
- c. A composite Form 2264-A that:
  - 1) Combines the maximum insurable mortgages and total requirements for settlement from of a. and b. above;
  - 2) Indicates the sources of funds to meet cash requirements.

C. Cost Certification.

1. Complete two separate cost certifications under existing and new construction instructions.
2. Consider only income during construction generated from the addition as a recovery of cost.

D. Financial Requirements to Close:

1. Minor non-realty equipment escrow and the Initial Deposit to the Reserve for Major movable Equipment (for rehabilitation projects only) must be funded at or before initial endorsement.

**NOTE:** 1) The minimum amount needed to fund the minor non-realty equipment escrow is based on \$450 per bed. 2) Funds may be released as equipment is purchased. 3) Any remaining balance in the escrow account may be released after all equipment has been purchased and the project is operational.

2. Independent living units in a board and care home may not exceed 25 percent of the total projected number of residents and require a 12-month prorated debt service reserve in

addition to any operating deficit escrow required for project approval. Any combination of independent living with a nursing home/intermediate care facility or a board and care facility requires a prorated debt service reserve (e.g., 25 percent independent living units would require 25 percent of the 12-month debt service reserve for the portion of the project used as a board and care home).

3. An assisted living facility may contain apartment-like units. Therefore, the Lender will calculate a prorated 12-month debt service reserve based upon the number of proposed independent living units.

E. Insurance of Advances.

1. See Chapter 13 for processing instructions.
2. Changes to the major movable equipment list:
  - a. The Lender and HUD must approve the change orders.
  - b. The owner must set up with the mortgagee a cash escrow to cover the increased cost, if any, within 5 days of HUD's approval of the new equipment list.
  - c. The increased cost of major movable equipment may be recognized for cost certification purposes but this is not a basis for a mortgage increase.

## 8.9

### Section 223(f) Firm Commitment Processing - Determining Mortgage Amounts, Cash Requirements, and Related Items

A. Firm Commitment Processing for Section 207 pursuant to 223(f):

1. Amount of loan in a purchase transaction.

In a purchase transaction involving an arm's length sale, the mortgage may not exceed the lowest of:

- a. Application amount; or
- b. An amount not to exceed the 85 percent for for-profit and nonprofit mortgagors of the result of the Lender's estimate of value as repaired less the amount of grant/loan funds attributable to replacement cost items.
- c. The maximum per unit limitation for new construction under Section 207.

NOTE: The per family unit limits may be increased. See paragraph 8.7 A.1.c.(3).

- d. Debt service that does not exceed the 85 percent for for-profit and nonprofit mortgagors of project's estimated net income. The mortgage may exceed this limit by capitalizing the savings from any tax abatement. In such cases the net earnings estimate will not reflect that temporary tax abatement.

- (1) That portion of the maximum mortgage supported by the tax abatement must be amortized over the life of the abatement.
  - (2) Tax Abatement must run with the real estate and not with the type of sponsorship
- e. Eighty-five percent for for-profit and nonprofit mortgagors of the cost of acquisition which is defined as the sum of the items:
- (1) Purchase price shown in the purchase agreement and determined allowable by the Lender.
  - (2) The Lender's estimate of repair cost, if any, provided such costs are paid by the mortgagor and are not included in the purchase price.
  - (3) The sum of reasonable financing charges, legal, organizational, and title and recording expenses paid by the mortgagor.
  - (4) Eligible discounts paid by the mortgagor.
- NOTE: Any fees, discounts or other amounts paid by the seller for or on behalf of the purchaser must be reflected as a reduction to the acquisition cost.
- (5) The initial deposit to the Reserve Fund for Replacement, provided such deposit will be funded by the purchaser.
  - (6) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable, and other fees as may be determined eligible by the Lender including the cost of Lender third party reports.
  - (7) Less the amount of any:
    - (a) Reserve escrow for replacement that will be purchased as an asset of the project.
    - (b) Grant/loan funds attributable to mortgageable items.

2. Amount of Loan in a Refinancing Transaction:

The subject loan will be the lesser of:

- a. Amounts in paragraph 8.9 A.1. except e.
- b. An amount which equals the greater of the following
  - (1) 80 percent of the Lender's estimate of the value of the project, or
  - (2) The cost to refinance the project which is defined as the sum of:
    - (a) The amount needed to pay off the existing indebtedness as determined eligible by the Lender.
    - (b) The initial deposit to the Reserve Fund for Replacements.
    - (c) The sum of reasonable financing charges, legal and organizational, and title and recording expenses paid by the mortgagor.

- (d) The Lender's estimate of repair cost, if any.
- (e) Eligible discounts paid by the mortgagor.
- (f) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable, and other fees as may be determined eligible by the Lender including the cost of Lender third party reports.
- (g) Less the amount of any:
  - (i) Reserve escrow for replacement and/or major movable equipment that will be purchased as an asset of the project.
  - (ii) Grant/loan funds attributable to mortgageable items.

B. Firm Commitment Processing for Section 232 Pursuant to Section 223(f)

1. Amount of loan in a purchase transaction.

In a purchase transaction involving an arm's length sale, the mortgage may not exceed the lowest of:

- a. Application amount; or
- b. For Proprietary mortgagors, 85 percent of the Lender's estimate of value as repaired including major movable equipment; or
- c. For Nonprofit mortgagors; or
  - (1) Ninety percent of Lender's estimate of value as repaired including major movable equipment.
  - (2) Sum of Lender's estimate of value including major movable equipment less grant/loan and gifts.
- d. Debt service supportable by 85 percent (90 percent for nonprofit mortgagors) of net earnings attributable to realty and nonrealty (excluding proprietary earnings). The mortgage may exceed this limit by capitalizing the savings from any tax abatement. In such cases the net earnings estimate will not reflect that temporary tax abatement.
  - (1) That portion of the maximum mortgage supported by the tax abatement must be amortized over the life of the abatement.
  - (2) Tax Abatement must run with the real estate and not with the type of sponsorship
- e. Eighty-five percent (90 percent for nonprofit mortgagors) of the cost of acquisition which is defined as the sum of items:
  - (1) Purchase price shown in the purchase agreement and determined allowable by Lender.
    - a. Do not recognize as part of the purchase transaction the cost of improvements made by a nonidentity of interest operator of a health care facility that has financed improvements to the facility with debt and now

is in the process of purchasing said facility and wants to include the cost of the improvements in the purchase transaction.

- (2) Lender's estimate of repair cost, if any, provided such costs are paid by the mortgagor and not included in the purchase price.
  - (3) Sum of reasonable financing, legal, organizational, title and recording expenses paid by mortgagor.
  - (4) Eligible discounts paid by the mortgagor.
  - (5) Initial deposit to the Reserve Fund for Replacements (realty) and the Reserve Fund for Major Movable Equipment (Nonrealty) funded by the purchaser.
  - (6) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable; other fees as may be determined eligible by the Lender including the cost of Lender third party reports.
  - (7) Less the amount of any:
    - (a) Reserve escrow for replacement and/or major movable equipment that will be purchased as an asset of the project.
    - (b) Grant/loan funds attributable to mortgageable items.
2. In a refinancing transaction, the owner is restructuring the mortgage debt against the property. The loan is the lowest of:
- a. Amounts in paragraph 8.9.B.
  - b. Cost to refinance the project which is defined as the sum of:
    - (1) Amount needed to pay off the existing indebtedness determined eligible by the Lender.
    - (2) Initial deposit to the Reserve Fund for:
      - (a) Replacements (realty).
      - (b) Major Movable Equipment (Nonrealty).
    - (3) Lender's estimate of repair cost, if any.
    - (4) Sum of reasonable financing, legal, and title and recording expenses paid by mortgagor.
    - (5) Eligible discounts paid by mortgagor.
    - (6) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable; other fees as may be determined eligible by the Lender including the cost of Lender third party reports.
    - (7) Less the amount of any:
      - (a) Reserve escrow for replacement and/or major movable equipment currently on deposit.

(b) Grant/loan funds attributable to mortgageable items.

C. Treat any property acquired:

1. Before the date of the original application as a refinance transaction; and
2. After the date of the original application as a purchase transaction.

D. Identity of Interest Purchase Transaction.

Refer to Chapter 14, Section 14.15

E. Determining Existing Indebtedness in a Refinancing Transaction.

Existing indebtedness in a refinancing transaction is defined as:

1. Outstanding mortgage(s) incurred in connection with the construction of the project or with capital improvements made to the property as confirmed by the current mortgagee using the pay-off letter which appears in Appendix 8C of this Guide.
2. Other recorded indebtedness such as mechanic's liens and tax liens provided they did not result from personal obligations of the mortgagor.
3. Unrecorded debt directly connected with the project supported by documentation from the mortgagor. If the indebtedness is not recorded, the mortgagor must provide the Lender with documentation which unquestionably identifies the indebtedness with the project. Examples are:
  - a. Delinquent interest
  - b. Prepayment penalties on the mortgage
  - c. Indebtedness incurred in making significant betterments to the property

NOTE: Program penalties arising from the defeasance of tax-exempt and taxable bonds cannot be recognized.

4. Line-of-credit portfolio indebtedness attributable to acquisition costs, repairs and capital improvements. The mortgagee must obtain a letter from the issuer of the line-of-credit listing each facility encumbered by the financing and the dollar amount needed for each facility to obtain a partial release from the financing. Absent the partial release information, the following are acceptable alternatives:
  - a. HUD will divide the line-of-credit debt by the total number of beds in the facilities to come up with the per bed debt. Or,
  - b. Based on MAP appraisals for all the facilities, HUD will add up the approved values for all the facilities. HUD will divide the line-of-credit debt by the sum of the values. Multiply the result by a facility's value to determine the amount of existing indebtedness to be assigned to a facility.
  - c. Lenders may develop other options for assigning debt. HQ will review and approve these options on a case-by-case basis.

## 5. Real Estate Investment Trusts (REITs)

We recognize that special circumstances may exist from time to time when dealing with REITs, therefore we will treat the cash payment for the facility in the same manner as line-of-credit financing with the following exceptions.

- a. The REIT must submit from an independent certified public accountant a report of the cash payment made from each facility.
- b. An authorized officer of the REIT signs and dates a cover letter to HUD attesting the accuracy of the report. Said letter must contain the 1010 criminal warning.
- c. HUD will recognize 75% of the cash payment as equivalent to existing debt.

## 6. Do not recognize indebtedness:

- a. Recently placed against the project to increase the mortgage or circumvent program intent.
- b. Created by wrap mortgages
  - (1) Unless the mortgagor and Lender give a detailed explanation of the purpose of the wrap and a documented accounting of disbursement of the loan proceeds.
  - (2) You may recognize loan proceeds used for capital improvements or project operations.

## F. Reserve for Replacements.

The initial deposit to the Reserve Fund for Replacements is eligible for inclusion in the maximum insurable mortgage.

## 1. Purchase Transaction.

- a. The purchase agreement must specify:
  - (1) Whether or not the transfer includes as an asset of the project, Reserve Fund for Replacements [or Reserve Fund for Replacements (Realty) and Reserve Fund of Major Movable Equipment (Nonrealty) in a Section 232 pursuant to 223(f) transaction] or other escrows.
  - (2) Dollar amounts of escrow and/or items which the seller will pay on behalf of mortgagor, e.g., the operating deficit, discounts, initial deposit to the Reserve fund for Replacements [or Reserve Fund for Replacements (Realty) and Reserve Fund of Major Movable Equipment (Nonrealty) in a Section 232 pursuant to 223(f) transaction] etc.
- b. Apply existing Reserve Funds transferred as an asset of the project as a reduction of acquisition cost when computing Criterion 7 on Form HUD 92264-A.

## 2. Refinancing Transaction. The mortgagor must submit a list of escrows currently on deposit for the project:

- a. The escrows must remain with the project.

- b. Apply funds currently on deposit in a Reserve Fund for Replacements as a reduction of:
  - (1) The cost of refinancing under criterion 10 on Form HUD 92264-A.
  - (2) The initial deposit to the Reserve Funds for Replacement [or Reserve Fund for Replacements (Realty) and Reserve Fund of Major Movable Equipment (Nonrealty) in a Section 232 pursuant to 223(f) transaction] at endorsement. Use the excess to cut the costs of discounts, miscellaneous fees and charges, etc., included in the determination of the maximum insurable mortgage.
- G. Discounts and/or Costs of Issuance associated with bond financing may be eligible for inclusion in the computation of Criteria 7 and 10.
  - 1. Review documentation regarding permanent financing. Documentation must state the amount of the discounts, financing fees, and/or costs of issuance to be charged and with whom they will be paid.
  - 2. Permanent Placement Fee. This fee must include all permanent placement expenses except discounts. Where GNMA Mortgage-Backed Securities (MBS) are involved and the mortgagee charges:
    - a. The maximum permanent placement fee, it may not assess an additional charge for either the MBS application fee and/or the securities custodial fee.
    - b. Less than the maximum permanent placement fee, it may assess an additional charge for either the MBS application fee and/or the securities custodial fee provided the total fees and charges do not exceed the dollar value of the maximum permanent placement fee.
  - 3. Determine if the discounts, financing fees and costs of issuance are reasonable and in line with prevailing market conditions and mortgage credit data.

Recognize financing fees and discounts charged by the permanent Lender, for inclusion in the mortgage:

- a. Bond fees included in the mortgage transaction:
  - (1) Where a project is to be financed through the sale of either taxable or tax-exempt bonds, the maximum financing fees allowable in the mortgage computation and recognizable for cost certification purposes is 5.5 percent of the mortgage amount. Any cost beyond the 5.5 percent must be paid from sources outside the mortgage.
  - (2) The maximum financing fee the mortgagee may retain for its own account is 3.5 percent. This 3.5 percent covers the costs of origination, processing, underwriting, closing and delivery (including the mortgagee's legal fees), escrow monitoring, permanent placement, etc. The remaining 2 percent (or such greater percentage as may result from the Lender reducing its maximum retainable 3.5 percent fee) may be used to offset the cost of bond fees.
- b. Discounts. In a refinancing or purchase transaction, discounts will be recognized only for those actual costs charged by the placement Lender which are determined to

be eligible. Discounts included in the computation of Criteria 7 and 10 must be reasonable based on current market conditions.

4. Do not recognize:
  - a. Financing fees and discounts beyond the 3.5 percent included in the mortgage where an identity of interest exists between:
    - (1) The sponsor/mortgagor and the new permanent Lender.
    - (2) The present permanent Lender or the interim Lender and the new permanent Lender, in a refinancing transaction.
  - b. GNMA application fee and securities custodial fee, where the GNMA Mortgage-Backed Securities Program will be used for permanent financing, since they are paid from the permanent placement fee.
  - c. Charges for warehousing a mortgage for future delivery.

## 8.10

### Secondary Financing - Section 223(f)

The terms and conditions of secondary financing are:

- A. The secondary financing is represented by a promissory note, Form FHA-2223. [For Section 232 pursuant to 223(f) transactions involving nonprofit mortgagors use a Residual Receipts Note (Nonprofit Mortgagors), Form FHA 1710.] This note shall not be altered in any manner.
- B. The amount of the secondary financing is based on the source of funding.
  1. When the loan is made by:
    - a. A Federal, State or local government agency or instrumentality the amount of the loan cannot exceed the difference between the HUD insured mortgage and the HUD Fair Market Value of the project. However, no other form of secondary financing may be used.
    - b. For other entities or natural persons [either alone or in combination with organizations listed in 1a], the aggregate amount of the insured first loan and the second loan cannot exceed 92.5 percent of HUD's Fair Market Value of the project.
  2. When the financing vehicle for the secondary financing is provided by a Federal, State or local government agency or instrumentality the amount of the loan cannot exceed the difference between the HUD insured mortgage and the HUD Fair Market Value of the project. However, no other form of secondary financing may be used. Examples of acceptable financing vehicles are 501(c)(3) tax exempt bonds issued by nonprofit organizations and the more common forms of tax exempt financing.
- C. Repayment of the secondary financing including interest is geared solely to the availability of surplus cash. Include the following language 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."

- D. The mortgagor may secure a promissory note with an inferior lien against the property under the following conditions:
1. The mortgagee of the HUD-insured first mortgage must consent to the placing of the inferior lien and agree that its existence doesn't constitute a basis for default on the first mortgage.
  2. There must be a simultaneous closing and same day recordation of the secondary financing documents and the insured first mortgage loan documents.
  3. The terms of the second mortgage are:
    - a. Approved by the Area Counsel;
    - b. Consistent with the terms of the promissory note, the first mortgage, the Regulatory Agreement and all HUD regulations and requirements.
    - c. The second mortgage shall not contain a cross default provision or any right of foreclosure before the termination of the HUD mortgage insurance.
    - d. 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 repaid in full.
      - (2) HUD grants a deferment of amortization or forbearance that results in an extended maturity of the insured mortgage.
    - e. The second mortgage is assumable when a sale or transfer of physical assets occurs and the mortgage insurance remains in place.
      - (1) The holder of the second mortgage cannot require that more than 70 percent of the net proceeds of the sale or transfer be 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:
          - (i) Required contributions to any reserve funds.
          - (ii) Needed improvements to the property as evidenced by HUD's annual inspection reports.

- f. The second mortgage automatically terminates if HUD acquires title to the project by a deed in lieu of foreclosure.
- g. Only 50 percent of surplus cash or residual receipts can be pledged to the repayment of the secondary loan(s). However, at the owner's option additional payments may be made from time to time.

## 8.11

### Firm Commitment Processing with Grants/Loans

#### A. In General

These instructions apply to:

1. Grants and loans to the mortgagor entity from a Federal, State or local government agency or instrumentality.
2. Loans to principals of the mortgagor entity from a Federal, State or local government agency or instrumentality.
3. Grants and loans to the mortgagor entity or its principals from national, regional and local community service organizations (nongovernmental source), e.g., Ford Foundation, Rockefeller Foundation, etc.

#### B. Application for Mortgage Insurance.

1. At the commitment processing stage, the applicant:
2. Identifies the use of grant/loan funds on Form HUD-92013, Application for Project Mortgage Insurance.
3. Submits either:
  - a. A commitment letter signed by an authorized agent of the government agency or instrumentality or the nongovernment source identifying:
    - (1) Amount of grant/loan funds.
    - (2) Intended use of the grant/loan funds.
    - (3) Any conditions for the loan and reasons, if any, the letter of intent could be withdrawn.
  - b. For those cases involving a grant/loan from a government/agency or instrumentality, an application showing the information above.

#### C. The Rental Housing Project Income Analysis (HUD-92264) and the Supplement to Project Mortgage Analysis (HUD-92264-A) are to be completed in accordance with instructions for each specific program.

#### D. Grants/Loans from government agency or instrumentality

1. Initial Endorsement
  - a. Before scheduling the closing, the Field Counsel must review the grant/loan documents to assure the legal sufficiency of the documents.
  - b. The Lender must consent in writing to the existence of the second mortgage and agree that its existence does not 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 Lender and the mortgagor which provides the following:
      - (a) HUD has:
        - (i) 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.
        - (ii) Sole authority to resolve differences in the inspection process and disbursement of grant/loan proceeds.
      - (b) The Lender will concurrently furnish HUD and the agency or instrumentality with copies of the approved interim advances [Form HUD-92448, Contractor's Requisition, Form HUD-92403, Application for Insurance of Advances of Mortgage Proceeds, and supporting documentation].
      - (c) The agency or instrumentality must process the advance promptly and without adjustment.
        - (i) Send the agency or instrumentality a copy of the approved requisition for its records.
        - (ii) The agency must notify HUD and the Lender of a need to make an adjustment the following month.
      - (d) The agency or instrumentality assumes the risk for any grant/loan funds disbursed in excess of the amount approved by HUD or the Lender and agrees to replenish the excess funds within 10 working days of notification by HUD or the Lender.
      - (e) If a 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.
      - (f) The agency's or instrumentality's attorney must render an opinion that the agreement and grant/loan commitment is legally binding on present and all future administrations.
      - (g) The mortgagor must post either a cash escrow or an unconditional, irrevocable letter or credit equal to no less than 10 percent of the grant/loan proceeds.

- (i) The Lender must draw upon the escrow if the government agency or instrumentality fails to advance the grant/loan proceeds in a timely manner.
  - (ii) The mortgagor must reinstate any portion of the escrow drawn during the term of the construction loan, within 10 days of the draft for payment.
  - (iii) HUD must establish control of the escrow in a separate agreement.
  - (iv) The escrow may be released at final endorsement.
- (3) Grant/loan proceeds must be advanced either:
- (a) Before mortgage proceeds, or
  - (b) Concomitantly on a pro rata basis with the disbursement of mortgage proceeds.
- NOTE: If the grant/loan proceeds are not available at initial endorsement, HUD may either:
- (i) Proceed to initial endorsement, but not disburse any mortgage proceeds until the grant/loan is in place and the funds are available, or
  - (ii) Have the mortgagor/sponsor fund an escrow equal to the grant/loan. Advances from this escrow must follow outstanding instructions for the disbursement of the grant/loan.
- (c) Release of grant/loan proceeds cannot be geared to the completion of specific improvements.

#### E. Grants/Loans from nongovernment source

##### 1. Commitment Processing.

- a. Financial statements must be submitted which evidence that the providing source has the financial capacity to meet its commitment.
- b. The latest 3 years published audited financial statements, if available, must be submitted.
- c. If audited financial statements are not available, unaudited statements which meet the requirements of paragraphs 8.4.B must be provided.

##### 2. Initial Endorsement.

- a. Before scheduling the closing, HUD reviews the grant/loan documents to assure the legal sufficiency of the documents.
- b. The grant/loan funds must be escrowed with the Lender before or at initial endorsement.
- c. The grant/loan funds must be disbursed before mortgage proceeds.
- d. Release of grant/loan proceeds cannot be geared to the completion of specific improvements.

3. All work performed with the grant/loan proceeds:
  - a. Must be cost certified.
  - b. Must conform with Davis-Bacon requirements including submission of payrolls, certifications, etc.

## 8.12

### Evaluating Nonprofit Sponsors and Mortgagors

#### A. General

Decide general eligibility of prospective nonprofit sponsor/mortgagor before issuing Pre-application approval or Firm Commitment as appropriate.

Prior to the issuance of the firm commitment, a HUD Headquarters review is required on all Section 22d(d)(3) MAP and TAP applications. In addition to exhibits 1 thru 10 listed below the following exhibits must also be submitted to the Office of Multifamily Development

1. A description of who is paying pre-development cost.
2. Details of proposed rent/income restrictions.
3. Copy of Form-2013, Application for Mortgage Insurance
4. Forms HUD 3434, Certificate of Relationships and Nonprofit Motives and HUD-3435, Certificate of Contractual Relationships.
5. Developers Agreement or any other document which shows the relationship and work responsibilities of all parties associated with the transaction.
6. Housing Consultant's contract, if applicable.
7. Evidence of site control.
8. Memorandum of Findings & Recommendations
  - a. It must include a description of the relationship between the nonprofit and profit motivated entities involved in the transaction.
  - b. The determination of eligibility or ineligibility of the nonprofit sponsor/borrower must be signed off personally by the Hub/Program Center Director.

#### B. Required Exhibits from Nonprofit Sponsor

Form HUD-3433, Request for Preliminary Determination of Eligibility as Nonprofit Sponsor and/or Mortgagor, and supplemental documentation. This type of sponsor must submit this information at the earlier of pre-application or Firm Commitment, as appropriate. Documentation must contain, but is not limited to:

1. Detailed explanation of motivation for sponsoring the project including a history of the organization's involvement in multifamily housing.
2. Copy of sponsor/mortgagor's charter and bylaws or constitution as currently amended.

3. Copy of a current effecting ruling form the Internal Revenue Service on sponsor/mortgagor's tax-exempt status.
  - a. Copy of any ruling denying tax exemption
  - b. If a ruling is pending, explain the application's legal and factual basis and current status.
4. List of officers, directors or trustees of the sponsoring group/mortgagor including addresses and titles of positions and their social security numbers.
5. Resumes on all principals and staff who will actively take part in the development of the proposed project.
6. Current financial statement (balance sheet, profit and loss statement, and supporting schedules) as well as statements for the past 3 years. If available, audited statements should be submitted.
  - a. If the sponsoring group/mortgagor has existed less than 3 years, the financial statements must be submitted from the date the group was formed.
  - b. Statements must identify restricted and unrestricted assets along with the related liabilities.
  - c. Financial statements must be signed by an officer of the sponsoring group.
  - d. All statements must contain the certification of truth and accuracy and criminal certification identified in paragraph 8.4.B.1.b. This certification must reference the name of the sponsor and the date of the financial statements.
7. Signed written resolution of its directors or trustees, acknowledging the responsibilities and obligations of sponsorship and continuing ownership, and that this position reflects the will of the membership.
8. Form HUD-92013-SUP listing current bank and trade references for the sponsor/mortgagor, if formed, and their officers (President, Vice President, Secretary and Treasurer).
9. The information contained in paragraph 8.3.G.1a, b, and c if the sponsor/mortgagor or any officer which has a prior Federal default or claim.
10. Detailed statement of arrangements made or proposed for the following (listing principals involved, their relationship with the sponsor/mortgagor, the terms of the arrangements and the circumstances surrounding each):
  - a. Land on which the project will be built.
  - b. Project construction, including selection of general contractor, subcontractors and architect.
  - c. Legal and consulting services.
  - d. Project financing, including any discounts.

NOTE: A national, State or regional organization acting as a cosponsor must submit a separate Form HUD-3433 and Supplemental documentation.

### C. Mortgage Credit Review Stage

1. Review Form HUD-3433 to see if the nonprofit sponsor/mortgagor is qualified to start, complete and operate a project under one of HUD's insured loan programs. Determine that all of the following criteria are satisfied:
  - a. Sponsor/mortgagor is acting on its own behalf and is not, either knowingly or unwittingly, under the influence, control or direction of any outside party seeking to derive a profit or gain from the proposed project—such as a landowner, real estate broker, contractor, architect, attorney or consultant.
  - b. Sponsor/mortgagor has continuity and a serious long-range desire to supply housing for the intended client group.
  - c. Sponsor/mortgagor has:
    - (1) Strong roots in the neighborhood and community
    - (2) Good reputation for reliability, service and commitment to the people for whom the housing is to be built.
  - d. Sponsor/mortgagor fully understands the responsibilities and obligations in developing a housing project and continuing its successful operation. This is evidenced partly by:
    - (1) General knowledge of the factors that contribute to project success or failure.
    - (2) Familiarity with the housing programs.
    - (3) Clear, specific objectives.
  - e. Sponsor/mortgagor acknowledges, by majority resolution of its directors or trustees, the responsibilities and obligations of sponsorship to develop and manage the project. This position reflects the will of its membership.
  - f. Sponsor/mortgagor and its principals are reliable based on:
    - (1) Reputation and Past Performance.
    - (2) Success and extent of previous experience, including the type of service furnished (financial, volunteer work, management, etc.), in providing housing or related social services.
  - g. Sponsor/mortgagor is providing or has arranged for the professional and management skills essential to the successful start, development, completion, and operation of the proposed project.
2. Credit investigation.
  - a. Order data and/or commercial credit reports on the sponsor/mortgagor, if formed, and the officers of the mortgagor entity and make inquiries of bank and trade references identified on Form HUD-92013 Sup to determine basic acceptability of credit reputation and previous experience.
  - b. Check for the existence of any delinquent Federal debt.

- c. Check with other HUD Offices in whose jurisdiction the nonprofit has done or now does business.
3. Analysis of financial data.
    - a. Determine:
      - (1) Amount of cash and liquid assets available for investment in the project.
      - (2) Whether the nonprofit entity has used prudent judgement in its past and present business affairs.
      - (3) Overall financial condition of the sponsoring group, particularly whether the financial statements indicate that income will be sufficient to met the expenses incurred by the group.
    - b. Financial statements of many large nonprofit organizations show various fund accounts, such as general and building fund, etc.
      - (1) Look out for interfund receivables and payables that cancel each other.
      - (2) Do not consider restricted-use funds in the analysis.
      - (3) Review Public Records section of credit report to eliminate assets which have been used as collateral in secured borrowing.
    - c. Project size should be in keeping with the abilities of the sponsoring organization.
- D. Submitting forms HUD-3434, Certificate of Relationships and Nonprofit Motives, and HUD-3435, Certification of Contractual Relationship.
1. At the Firm Application stage and prior to initial endorsement (beginning of construction in the case of insurance upon completion), the sponsor and mortgagor must certify on Form HUD-3434, their relationships with parties or firms furnishing land and services.
  2. Such parties or firms certify on Form HUD-3435 their relationship with the sponsor and mortgagor.
  3. If there is a change in the certified relationship, the sponsor, mortgagor and other parties must furnish additional certifications with respect to each change.
  4. All relationships are subject to HUD approval. HUD reserves the right to refuse endorsement of the note for insurance and to cancel the commitment if such relationships aren't approvable.
- E. Nonprofit Sponsor and a Profit-Motivated Mortgagor Entity.
- A nonprofit sponsor may request to establish a profit-motivated mortgagor entity for the purpose of obtaining BSPRA and distributions from surplus cash. Such a request may be approved provided:
1. The HUD Field Counsel determines that there is no legal impediment which would prohibit approval of the request.

2. The nonprofit agrees to be regulated by the terms and conditions of the regulatory agreement applicable to a profit-motivated entity.
3. The nonprofit is subject to the mortgage limitations applicable to a profit-motivated entity.
4. A working capital deposit is required.
5. A nonprofit developer's fee is not included in the mortgage.
6. If the nonprofit provides evidence that it has obtained exemption from real estate taxes, the tax exemption must run with the real estate and not with the type of sponsorship.
7. The potential tax consequences as well as the possible effect on the nonprofit's Section 501(c)(3) status with the Internal Revenue Service (IRS) is between the nonprofit and the IRS.
8. Form HUD-3433 is not required for such cases.

**8.13****Insurance Upon Completion (IUC)**

Insurance Upon Completion is an option for new construction and substantial rehabilitation projects financed under Sections 221(d), 220 and 232. Mortgage insurance is provided after project completion. The following instructions apply to IUC projects:

- A. A financial and credit investigation will be required on the borrower and its principals.
- B. MIP is not included in Form HUD-92264 nor it is charged until the project reaches endorsement
- C. Working Capital Deposit is not required in IUC projects.
- D. Assurance of Completion is not applicable to IUC projects. At endorsement, the general contractor must satisfy latent defects by:
  1. Setting up a cash escrow deposit equal to 2-1/2 percent of the mortgage, or
  2. Providing a surety bond equal to 10 percent of cost of construction or substantial rehabilitation.
- E. Breakdown of Financing Charges: In IUC projects, before issuance of the Firm Commitment,
  1. The mortgagee must provide:
    - a. A breakdown of financing charges and discounts by submitting Form FHA-2455, Request for Endorsement of Credit Instrument, Certificate of Mortgagee, Mortgagor and General Contractor, with the Certificate of Mortgagee portion completed. The balance of the Form is to be completed before Final Endorsement in lieu of Form FHA-2023.
    - b. Information relative to the construction and permanent interest rates and mortgage term.

2. Each item is reviewed to ensure its reasonableness in relation to comparable projects and market conditions. The approved fees set to the upper limit for cost certifications purposes.
  3. HUD must inform the mortgagor of the fees that are recognizable for cost certification.
- F. Building Loan Agreement, Form HUD-92441, is not applicable to IUC projects.
- G. Construction Change Orders. The procedure for change orders is the same as in Chapter 13 except as modified below:
1. Positive change orders in excess of \$5,000. While the mortgagor must be able to provide the additional funds required, an escrow is not required. The mortgagor must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented for insurance.
  2. Approval of the surety is not required when approved changes increase cost by 10 percent or more.

**8.14****Determining the Estimated Cash Requirements for Completing the Project**

Estimating financial requirements for completing a multifamily project is essential for determining the net amount of cash or its equivalent needed to close the transaction. Total the following:

- A. Lender's total estimated development cost. Also include the amount by which the:
1. Contractor's and/or mortgagor's estimate for construction exceeds Lender's estimate.
  2. Owner/Architect Agreement for design and/or supervisory services exceeds Lender's estimate.
  3. Consultant's contract for services exceeds Lenders estimate.
- B. Amount necessary to clear all debts on the land (or property if substantial rehabilitation). All indebtedness must be verified by the Lender. In purchase transaction, include other costs associated with the acquisition that will not be recoverable form mortgage proceeds, i.e., zoning costs.
- C. Estimated cost of offsite improvements and demolition.
- D. Cost of equipping and furnishing a project with nonrealty items, if applicable. Use the higher of Lender's estimate or the mortgagor's estimate.
- E. Required working capital deposit, if required.
- F. Operating deficit, if any.

- G. Commitment, marketing fees, and discounts.
- H. Cost of issuance to be paid out-of-pocket by the sponsor/mortgagor for tax-exempt or taxable bond financing.
- I. Relocation payments not included in Lender's estimated replacement cost on Form HUD-92264-A.

Deduct the maximum insurable mortgage, any grant/loan funds attributable to replacement cost items and fees not to be paid in cash. The remainder is the estimated capital needed for the project.

Set forth these conclusions and the mortgagor's ability to close the transaction on Form HUD-92264-A.

This is general methodology. The Lender's underwriter is responsible for completing the HUD-92264-A for the appropriate program in order to determine cash requirements.

## 8.15

### Bond Financed Projects

- A. Review of Financing Documents. Financing documents associated with mortgage bonds are not reviewed.
  - 1. The sponsor must submit, with the application for commitment processing, a separate statement itemizing the estimated costs of issuance, discounts and financing fees to be paid out of pocket by the sponsor/mortgagor and explaining the necessity of each cost.
  - 2. Mortgage Credit.
    - a. The Lender's underwriter checks the statement for reasonableness, using the data from previously processed bond financed projects.
    - b. Make adjustment where appropriate.
    - c. Uses this information to develop the Total Estimated Cash Requirement Form HUD-92264-A, Supplement to Project analysis.
- B. Loan Rates.
  - 1. If the bond obligations have a variable interest rate, the rate must have a cap which is below the permanent loan rate. The permanent loan rate must exceed the interest rate on the bond obligations.
  - 2. In many cases, the interest rate on the bonds is unknown during the commitment process. Therefore, it is not uncommon for the mortgage interest rate to change once the bond

interest rate is established. Due to time constraints, if the mortgage rate is lower, HUD may not have sufficient time to reprocess the project. In such cases:

- a. The Firm Commitment must contain the following condition:

“Any interest savings resulting purely from a differential between the HUD processed interest rate and the actual final interest rate may not be construed as excess funds that may be used to offset costs in other categories at the time of cost certification. Any such savings must be applied as a mortgage reduction.”

- b. An exception is that savings resulting from the early completion of construction may be used to offset cost certifiable overruns in other cost categories. Compute interest savings by:

- (1) Recalculating the interest line item on Form HUD-92264, using the actual interest rate for the scheduled construction period.

- (2) Subtracting the actual interest cost recognized at cost certification from the revised interest figure developed in (1) above.

3. HUD will allow for the inclusion of a total financing and placement fee of 5.5% on bond financed applications, for all MAP eligible Sections of the Act, in determining the replacement cost mortgage amount and a cap of 5.5% recognized at cost certification.

C. Bonds may be sold at a premium to investors, i.e., investor pays an amount in excess of the face value of the bonds. The premium results from the bonds carrying a higher coupon rate than is generally available in the marketplace. The premiums must be considered as excess income and may therefore be used to offset cost overruns on recognizable certified cost.

1. Traditionally, HUD does not look at the mortgagee's cost of funds. Any premium raised by a transaction is considered part of the mortgagee, bond underwriter or issuer's profit. However, if a mortgagee gives something of value without the expectation of being repaid, HUD considers this to be a kickback. The one exception involves tax-exempt bond transactions where the issuer of the bonds may permit the mortgagor to receive some portion of the premium. In this situation, the mortgagee, bond underwriter and issuer are simply conduits for the transfer of funds.

2. If any of the premium is returned to the mortgagor, it is considered excess investment income and is treated as project income and used to reduce the total allowable cost of the project.

3. For **all** MAP eligible Bond Financed Projects, the premiums may be treated as project income under the following conditions:

- a. The sponsor/mortgagor entity cannot benefit monetarily from the excess investment

income.

- b. The premium, if given to the sponsor or mortgagor entity it controls, is considered as excess investment income.
  - c. Closing documents must detail the amount of the premium being given to the sponsor or the mortgagor entity it controls.
  - e. The premium may be used to pay for additional cost associated with the cost of issuance and may be applied to other recognizable cost overruns.
  - f. The mortgagor's accountant for an audited cost certification, or the mortgagor for an unaudited cost certification, must detail in the notes to the financial statement the amount of excess income received.
4. On nonprofit applications, excess income generated from premiums may be applied to recognizable cost overruns. Any excess income over and above that used towards recognizable cost overruns must be transferred to the reserve for replacement account.
- D. Itemized Statement of Costs. Attached to and reflected in the Mortgagee's Certificate, Form HUD-92434, is an itemized statement of the costs of issuance of the obligations, discounts, and financing fees paid through the mortgagee.
1. The statement must explain why each individual item is necessary for the issuance of the obligations.
  2. Review the amount of each item to ensure its reasonableness in relation to comparable projects.
  3. HUD will prepare a letter from the HUD Director informing the mortgagee that HUD will recognize for cost certification purposes the costs of issuance, discounts, and financing fees in an aggregate amount not to exceed 5.5% included in the mortgage for all MAP eligible programs.
  4. The mortgagee, bond underwriter, and issuer have the option of deferring collection of additional discounts, financing fees, slow draw fees, etc., through the provision of Paragraph 18(f) of the Mortgagee's Certificate (Form HUD-92434).
    - a. The deferred collection of these items must be an obligation of a third party and both the third party and the mortgagee, bond underwriter or issuer must attest in writing that they will not look for payment from:
      - (1) Mortgagor;
      - (2) Mortgaged property;

- (3) Mortgage proceeds;
  - (4) Any reserve or deposit required by HUD and/or mortgagee in connection with the mortgage transaction; or
  - (5) Rents or other income from the mortgaged property.
- b. The mortgagor entity may issue, as evidence of the debt, a surplus cash or residual receipts note to the third party for costs identified in Paragraph 4 above which HUD determines to be reasonable.
- E. Pre-Cost Certification Conference Information. Explain at the pre-cost certification conference that:
1. Net effect of negative interest arbitrage (capitalized interest) may be recognized if there are offsetting savings in the mortgage.
  2. Any rebate to the sponsor/mortgagor from either the mortgagee, issuer, or bond underwriter automatically reduces the mortgage at cost certification. The following are two samples of the most common types of rebates.
    - a. Mortgagee/bond underwriter contributes a portion of the initial service charge that was collected to pay discounts or other fees.
    - b. Mortgagee/bond underwriter refunds a portion of the construction loan interest to the mortgagor or sponsor.

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**8.16****Lender's Review and Recommendation**

The Lender's underwriter's recommendation after review of all processing is made in a report addressed to HUD.

- E. The report must detail the project's financial requirements and the credit capacity of the sponsors and general contractor. Include, at minimum:
1. Name of the mortgagor entity.
  2. Composition of the mortgagor entity.
  3. Name of general contractor.
  4. Mortgage amount and controlling criterion.
  5. Financial requirements for closing.
  6. Sources of funds to meet cash requirements.

7. The experience level of the development team relative to the proposed project.
  8. A credit and financial review of sponsor(s) mortgagor and key principals and general contractor. This review must address positive and negative findings known by the Lender.
  9. Bonding requirements.
  10. Recommendation to accept or reject.
  11. If accepted, any conditions to be included in the commitment.
- F. Completed Form HUD-92264-A and exhibits for the type of mortgage proposed must be submitted to HUD.
- G. The Lender will transmit to HUD all mortgagor submissions and related documents.

**8.17****Firm Commitment Processing-HUD Duties and Responsibilities**

- A. Receiving HUD Approval to Participate in HUD Programs Previous Participation Certification:
1. Principals of project applying for mortgage insurance under HUD programs are subject to HUD approval based on their experience and participation in previous HUD projects. Form instructions indicate who must submit the form and the information to be provided. HUD staff will review the Form HUD-2530 Previous Participation Certification to establish the percentage of ownership interest, if any, the principal will have in the proposed project. In addition, a review will be made of the principals or participants role and status of previous projects. Principals must disclose any defaults, mortgage relief, assignments, and foreclosures relating to these projects.
  2. HUD will advise the mortgagee of its findings. If HUD rejects a principal, their withdrawal does not necessarily result in a rejection of the application if it can be determined that the remaining principals can successfully proceed with the project.
- A. HUD will review the Lender's underwriters report and the HUD 92264-A and will determine the following:
1. The acceptability of the sponsor, mortgager and its key principals, and the contractor.
  2. The maximum insurable mortgage.
  3. The total financial requirements for settlement.
- B. HUD will verify, through use of the HUD 92264-A and documents supplied by the Lender, the sources of funds to meet cash requirements.

- C. The HUD technician responsible will forward their recommendations (Format in Appendix 8) to the Team Leader.