

12.1 Initial Closing

12.1.1

Objective

- A. Guide the mortgagee, mortgagor and HUD Multifamily Hub Director (Hub Director) in preparing and reviewing documents for the initial closing for projects with insured advances. The Hub Director is the organizational position to which the Regulations and current administrative notices delegate the responsibilities for insuring an FHA loan. Note: Wherever the term “Hub Director” is used in this chapter it shall be deemed to include the Program Center Director where closings are processed in a Program Center.
- B. Assist the Multifamily Hub Staff, HUD Field Counsel and other HUD staff in preparing for and conducting the closing.
- C. Guide the mortgagor, the mortgagee and their attorneys in preparation for closing.

12.1.2

Authority and Responsibility for Closing

- A. The Hub Director is responsible for:
 - 1. Assuring that conditions of the HUD Firm Commitment are met.
 - 2. Distributing the closing documents to the appropriate HUD staff, including the field office chief counsel. Each HUD review team member will complete the appropriate programmatic checklists and related documents in Appendix 12A.
 - 3. Establishing the place for the closing, following consultation with the HUD closing attorney and the mortgagee.
 - 4. Notifying the mortgagee and the mortgagor of the closing date, time and location.
 - 5. Ensuring that a representative from the Office of Multifamily Housing with knowledge of the project being closed and authority to make decisions attends the entire closing, along

- with the HUD closing attorney. In addition, the Hub Director will ensure that the requirements of Appendices 12E-12H have been completed.
6. Establishing processing priorities and start of construction target dates, and monitoring construction schedules.
 7. Directing all activities essential to the insurance of mortgages, including approval of:
 - a. Findings of acceptability with respect to program policy and eligibility criteria,
 - b. Subordinates' preliminary underwriting determinations supporting insurance endorsements,
 - c. Mortgagor entity,
 - d. Eligibility statements.
 8. Coordinating crosscutting office support activities required for multifamily mortgage insurance.
 9. Obtaining Headquarters' approval of any credit subsidy, where required.
 10. Establishing the financial requirements for closing.
 11. Endorsing the note for mortgage insurance.
 12. Waiving the requirement for a pre-construction conference based on the experience of the participants.
- B. HUD closing attorney is responsible for:
1. Advising the Hub Director or his/her designee of the legal sufficiency of all closing documents. Legal sufficiency means that all closing documents include all required provisions and comply with applicable statutory and regulatory requirements. The Multifamily Hub staff must ensure that the contents of the documents are programmatically accurate.
 2. Setting date and time of closing after consultation with the Hub Director, Mortgagee, and Mortgagor and after reviewing the full set of closing documents submitted by the Mortgagee.
 3. Conducting the closing. (The lists of required closing documents are found in Appendix 12.)
- C. Mortgagee (or its attorney) is responsible for preparing and reviewing the closing documents and then submitting three complete draft closing packages to the Hub Director early enough for HUD to complete its review prior to the date of the closing. One package is for the HUD closing attorney and two are for the Multifamily Hub staff and other technical disciplines. The Hub Director may request a different number of closing packages to be submitted if it is necessary.
1. For HUD to accept the draft closing package for review:
 - a. All documents, not previously accepted by HUD, including a pro forma title policy (including legible copies of all exception documents), must be submitted at one time, and

- b. Forms and exhibits must be completed.

Note: Documents previously submitted to, and accepted by, HUD do not need to be resubmitted at closing. The Hub Director will be responsible for providing the documents that have already been previously accepted by HUD to the HUD closing attorney.

2. For HUD to schedule the closing, the HUD closing attorney and the Hub Director must have reviewed and approved all of the closing documents.

12.1.3

Closing Location

- A. The Hub Director is responsible for arranging accommodations for the closing, if the closing is held at HUD. In determining the location for the closing, the Hub Director will take into consideration project remoteness, e.g., where an office has multiple state jurisdiction, and whether a particular Field office will have an individual present who is authorized to make decisions for HUD and to endorse the Note. The closing may be held at a location other than a HUD office if the mortgagee, mortgagor and Hub Director all agree that it is appropriate to do so. If the closing is held at a non-HUD location, the mortgagee and mortgagor will be responsible for arranging closing facilities.
- B. Initial closings also may be conducted by escrow or by mail, at the request of the mortgagor and mortgagee, if the HUD attorney determines such closing is appropriate under the circumstances of the particular case. HUD is under no obligation to endorse the note for insurance until all of the documents are presented to, and approved by, the Hub Director.
- C. Except for the title policy, the mortgagor's attorney's opinion, and the incumbency certificate, if any, the documents may be dated and/or recorded prior to the day the note is endorsed by HUD for insurance. To the extent possible, however, all documents except the title policy and mortgagor's attorney's opinion should be dated with the same date. The fully executed original mortgage and UCC-1, Regulatory Agreement executed by the mortgagor and any other agreements, if applicable, should be submitted for HUD review enough in advance to allow for the Regulatory Agreement to be reviewed by the HUD closing attorney and executed by a HUD official, all the recordable documents to be reviewed by the title company or other entity tasked to provide for the recording of documents, and the documents to be in the hands of the person designated by the title company to record. Mortgagor and Mortgagee assume all risks associated with the recording or execution of any documents prior to the date of the endorsement of the Note by HUD.

12.1.4

Closing Forms and Documents

Closing forms and documents are listed in Appendix 12A and must be used in all closings for programs covered by the Guide (See Paragraph 1.4B.), unless a substitute has been approved in

writing by the Assistant General Counsel for Multifamily Mortgage Insurance. Local field offices are not authorized to modify the closing list except to meet the requirements of local law or custom or to meet the unique requirements of a particular case. The closing attorney will inform the mortgagee of any modifications to the closing list in Appendix 12A. The mortgagee's attorney must submit the draft closing packages to the Hub Director who will distribute the appropriate documents to the field counsel and to the housing program and technical discipline sections for document review and completion of the review sheets. The project number should be typed on each closing document if not otherwise included in the document. The Hub Director will provide a statement to the HUD closing attorney that all administrative requirements have been met. HUD/FHA administrative and closing forms may not be waived or changed, except as follows:

- A. The Multifamily Hub Director may approve administrative changes to any form, if the changes are required by local law or custom or the unique requirements of the particular case except those items specifically listed in 11.2.I. All such changes must be identified in the closing attorney's Certificate in the Washington Docket.
- B. HUD closing attorney may approve legal changes to any form, if the changes are required by local law or custom or the unique requirements of the particular case. All changes must be identified in the closing attorney's Certificate in the Washington Docket.
- C. Any changes in the forms must be identified in the mortgagor's attorney's opinion.
- D. Title. Marketable title to the property must be vested in the mortgagor on the date the mortgage is recorded. See requirements of Mortgagee's Certificate, paragraph (3). Mortgagor must provide and HUD must review title documents for initial closing as follows:
 1. The Multifamily Hub Director is responsible for:
 - a. Determining the acceptability of the mortgagor's proposed title company as indicated by the prior experience that the Hub has had with that company.
 - b. Assuring that any title exceptions do not adversely affect project value or marketability, or where a clear determination cannot be made, refer the exception to Headquarters, Office of Business Products. (The Hub Director should assure that the proposed construction contract documents and other contractual obligations call for the project to be constructed and managed consistent with the project's legal restrictions and covenants.)
 2. HUD closing attorney is responsible for:
 - a. Determining that the insured mortgage constitutes a valid first lien,
 - b. Identifying title conditions, covenants and restrictions that violate Federal statutes or regulations, or the Regulatory Agreement, and directing the mortgagee to eliminate them from the title, and
 - c. Bringing any title conditions, covenants or restrictions, including air right provisions, leasehold contracts, and common use easements and maintenance agreements, to the Hub Director's attention. It is the decision of the Hub Director whether or not to insure with these items.

3. Title Evidence. The mortgagee must provide a policy of title insurance, surveyor's certificate and survey of the covered property that are acceptable to HUD. The Hub Director may accept an alternative to a title policy in accordance with Paragraph 5 below, where satisfied after consulting with the HUD closing attorney who has determined that a title policy cannot be furnished. Any required policy of title insurance, survey or surveyor's certificate must be furnished without expense to HUD. The Note cannot be endorsed without delivery of an acceptable duplicate original title policy to HUD.
4. Title Insurance Policy must be issued by a title company acceptable to HUD in the ALTA format approved by HUD and, unless otherwise approved by the HUD closing attorney, must:
 - a. Be in an amount at least equal to the full amount of the insured mortgage.
 - b. Name the mortgagee and Secretary of HUD and his/her successors and assigns as the insured parties as their interests may appear.
 - c. Provide the 1997 ALTA Policy and ALTA Form 8.1 Environmental Endorsement. The ALTA Form 9 Comprehensive Endorsement, Zoning Endorsement, and the Endorsement insuring over easements that cannot be platted may be required by the closing attorney, if applicable. A zoning letter may be accepted by the closing attorney instead of a zoning endorsement. The Office of General Counsel has advised that there is no objection to the use of the 1999 Minimum Standard Detail Requirements (MSDR) for (ALTA)(ACSM) Land Title Surveys for multifamily projects insured by FHA.
 - d. Show the insured mortgage as the first lien. The insured mortgage and the Regulatory Agreement must appear in Schedule A-1 and the financing statements in Schedule B, Part II.
 - e. Show no monetary liens other than the insured mortgage, real estate taxes not yet due and payable, and any other liens that the Hub Director approves.
 - f. Show the deletion of all standard exceptions, such as the exception concerning mechanic's liens, claims to water, patent reservations, etc.
 - g. Be dated the day of endorsement.
 - h. The legal description in the policy must agree with the legal description in the survey and in all closing documents bearing a legal description.
 - i. For projects already constructed, the policy must include standard endorsement forms 100 and 116. To the extent that the policy reveals any encroachments that are not covered by form 100, additional affirmative protection will be required.
 - j. Any reference to taxes shall specify that the taxes are not due and payable. All due and payable taxes shall be paid prior to or at closing.
 - k. If the title policy contains any exception for mineral rights, it also must include an endorsement offering affirmative protection against loss due to such matters.

- l. All other exceptions must be acceptable to HUD.
 - m. Contain no exception for encroachment and other matters that a valid survey would disclose.
 - n. Delete any arbitration requirements except where such deletions are prohibited by State law.
5. Alternate Evidence of Title. Where acceptable to the Multifamily Hub Director, as provided in paragraph D.3, above, the mortgagee may use one of the following types of title evidence:
 - a. Abstract of title acceptable to HUD, prepared by an abstract company or person engaged in the business of preparing abstracts of title, accompanied by a legal opinion satisfactory to HUD, as to the quality of such title, signed by an attorney-at-law experienced in the examination of titles;
 - b. A Torrens or similar title certificate; or
 - c. Evidence of title conforming to the standards of a supervising branch of the Government of the United States of America, or of any State or Territory thereof.
 6. Surveyor's Report, Form HUD-2457, signed within 120 days before initial closing by a licensed surveyor and bearing the surveyor's professional seal. The Surveyor's report must be prepared in accordance with its attached instructions.
 7. Survey. The survey must conform with the instructions on the back of the Surveyors Report, Form HUD-2457, and be dated, signed and sealed within 120 days before initial closing. The Survey should show all easements or encroachments upon the property. These easements or encroachments must be acceptable to HUD.
 - a. The Hub Director may permit substitution of paragraph 7.a(1) below for the Form HUD-2457 requirement that, "The certificate should be addressed, to wit: "To all parties interested in title to premises surveyed," where the Form HUD-2457 requirement causes unwarranted legal difficulties or liability insurance costs. The certification must include the language contained in the instructions on the reverse of the surveyor's report, Form HUD-2457. (See paragraph 7a(2) and 7a(3), below.
 - (1) "I hereby certify to the U.S. Department of Housing and Urban Development (HUD), (Borrower), (Sponsor), (Lender), (Title Insurance Underwriter), (other), and to their successors and assigns, that:"
 - (2) "I made an on the ground survey per record description of the land shown hereon located in (city or town, country, township, etc.), on ___(date)___; and that it and this (these) map(s) was (were) made in accordance with the HUD Survey Instructions and Certificate, Form-HUD-2457 and meet the requirements for a Land Title Survey, as defined in the "Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys," dated 1999."
 - (3) "To the best of my knowledge, belief and information, except as shown hereon: There are no encroachments either way across property lines; title lines and lines of actual possession are the same; and the premises are free of any (subject to a) 100/500 year return frequency flood hazard, and such flood free (flood) condition

is shown on the Federal Flood Insurance Rate Map, Community Panel No. _____ (state, if none).”

8. Air Rights Projects

- a. A three dimensional air rights map for air rights projects is required. The existence of adequate vertical ways to the ground for required services, e.g., utility and fire suppression lines, chimneys, trash chutes, elevators and emergency exit stairs must be verified. In addition, there must be an acceptable discharge to a public way from all building egresses, including emergency exits, and services, e.g., trash removal.
- b. Maintenance Agreements. In cases where common facilities exist between the insured parcel and an adjacent parcel, the mortgagor must provide for recordation of a maintenance agreement for the common use facilities, e.g., common drives; common lobbies, parking structures, or other air rights project common facilities; etc. The Hub Director must:
 - (1) Assure that the integrity and maintenance of air rights platform foundations and other structural members are defined as the air rights provider's responsibility.
 - (2) Verify that shared maintenance/operating costs are equitable and that enforcement rights protect the project interests.

E. Leaseholds. Leaseholds must conform to the FHA Lease Addendum Form FHA-2070.

1. The term of The Lease Addendum may be varied to conform with applicable State and local law, except that the HUD closing attorney must approve:
 - a. The legal need for any proposed lease term changes, and
 - b. That any term changes are consistent with the following requirements of the Section of the Act under which the project is underwritten:
 - (1) Section 207/223(f). The lease term must satisfy one of the following requirements):
 - (a) Term is 99 years and is renewable, or
 - (b) Term is at least 50 years from the date the mortgage is executed (where a lease is on trust/other land on a reservation the HUD closing attorney must ensure that the lease provisions are coordinated with Bureau of Indian Affairs requirements).
 - (2) Sections 220, 221(d) and 232. The lease term must satisfy one of the following requirements:
 - (a) Term is 99 years and is renewable, or
 - (b) Term has at least 10 years to run after maturity date of the mortgage.
2. HUD needs to ensure the non-default status of any ground lease that exists at the time of closing. This can be done by collecting an estoppel certificate from the lessor as part of the closing package. This certificate should be dated within 30 days of closing and state

that the lessee is current on all rents due, the lessee is not in default of any lease provision and no event has occurred which, with the passage of time, would be a default under the lease.

- F. Organizational Documents. Organizational documents for the mortgagor entity are required to be submitted at closing. They must expressly indicate that the duration of the ownership entity is at least ten years longer than the term of the FHA-insured mortgage, that the terms of the Regulatory Agreement take precedence in the event of any conflict with the terms of the organizational documents, that the ownership entity has authority to enter into the transaction and to comply with the requirements of the insurance program and that unless approved otherwise by HUD, the mortgagor is a single asset entity.
1. The operating or partnership agreements, Limited Liability Corporation documents, or articles of incorporation for the mortgagor entity must include provisions stating that:
 - a. If any of the provisions of the organizational documents conflict with the terms of the note; mortgage, deed of trust or security deed; security agreement or HUD Regulatory Agreement ("HUD Loan Documents"), the provisions of the HUD Loan Documents will control.
 - b. No provision required by HUD to be inserted into the organizational documents may be amended without prior HUD approval, so long as HUD is the insurer or holder of the note.
 - c. No provision in the organizational documents that results in any of the following will have any force or effect without the prior written consent of HUD:
 - (1) Any amendment that modifies the term of the mortgagor entity;
 - (2) Any amendment that activates the requirement that a HUD previous participation certification be obtained from any additional member;
 - (3) Any amendment that in any way affects the note, mortgage, deed of trust or security deed, and security agreement on the Project or the Regulatory Agreement between HUD and the mortgagor entity;
 - (4) Any amendment that would authorize any member other than the Manager/General Partner or pre-approved Successor Manager/General Partner to bind the mortgagor entity for all matters concerning the project which require HUD's consent or approval;
 - (5) A change in the Manager/General Partner or pre-approved Successor Manager of the mortgagor entity; or
 - (6) Any change in a guarantor of any obligation to the Secretary.
 - d. The mortgagor entity is authorized to execute a note, mortgage, deed of trust or security deed and security agreement in order to secure a loan to be insured by the Secretary and to execute the Regulatory Agreement and other documents required by the Secretary in connection with the HUD-insured loan.

- e. Any incoming member/partner/owner must as a condition of receiving an interest in the Company agree to be bound by the note, mortgage, deed of trust or security deed, security agreement, the Regulatory Agreement and any other documents required in connection with the HUD-insured loan to the same extent and on the same terms as the other members.
 - f. Notwithstanding any other provisions, upon any dissolution, no title or right to possession and control of the Project, and no right to collect the rents form the Project, shall pass to any person who is not bound by the regulatory Agreement in a manner satisfactory to the Secretary.
 - g. The members, partners, officers and directors and any assignee of a member/partner are liable in their individual capacity to HUD for:
 - (1) Funds or property of the Project coming into its possession, which by the provisions of the Regulatory Agreement, the person or entity is not entitled to retain;
 - (2) Its own acts and deeds, or acts and deeds of others which it has authorized, in violation of the provisions of the Regulatory Agreement;
 - (3) The acts and deeds of affiliates, as defined in the regulatory Agreement, which the person or entity has authorized in violation of the provisions of the Regulatory Agreement; and
 - (4) As otherwise provided by law.
 - h. The company shall not voluntarily be dissolved or converted to another form of entity without the prior written approval of HUD.
 - i. The company has designated [insert name] as its official representative for all matters concerning the project which require HUD consent or approval. The signature of this person will bind the company in all such matters. The company may from time to time appoint a new representative to perform this function, but within 3 business days of doing so, will provide HUD with written notification of the name, address, and telephone number of its new representative. When a person other than the person identified above has full or partial authority of management of the project, the company will promptly provide HUD with the name of the that person and the nature of the that person's management authority.
2. Corporate Mortgagor
- a. Copy of Articles of Incorporation and Code of Regulations or Bylaws and all amendments thereto, certified by jurisdiction where filed;
 - b. Certificate of Good Standing. A certificate of good standing from the state where the project is located and, if the mortgagor is a foreign corporation, the state of incorporation or an opinion from mortgagor's attorney that such certificate is not required in that jurisdiction;
 - c. Enabling resolution which authorizes the loan and designates the appropriate officer(s) to execute the loan documents; and

- d. Incumbency Certificate certified by corporate officer.
 - e. Corporate articles of incorporation and bylaw provisions which make the corporation responsible for indemnifying its officers and/or board members are not acceptable, except to the extent mandated by state law and/or to the extent that such indemnification is limited to liability insurance coverage or distribution approved by HUD from residual receipts or surplus cash.
3. Partnership Mortgagor
 - a. Certified copy of Partnership Agreement and all amendments thereto;
 - b. Copy of Certificate of Partnership, if applicable, which has been recorded in the appropriate jurisdiction, if required. If the mortgagor is a foreign partnership and the application for registration as foreign partnership, and an indication that it is qualified to do business where the project is located.
 - c. Copy of the "Full Force and Effect" Certificate or Certificate of Good Standing or like certificate, if any, provided by the state; and
 - d. If less than all the general partners are signing the loan documents, a partnership resolution which authorizes the loan and designates the appropriate partner for signing.
 4. Limited Liability Company Mortgagor
 - a. Certified copy of Articles of Organization and Operating Agreement or Code of Regulations and all amendments thereto;
 - b. Certificate of Continued Existence. If the mortgagor is a foreign limited liability company holding a license as a foreign LLC under laws of the state in which the project is located, a certified copy of said license, and Continued Existence from the state of organization, or a legal opinion from an attorney licensed to practice in the state in which the project is located, that the company is qualified to do business and hold title to real estate in that state;
 - c. Enabling resolution which authorizes the loan and designates the appropriate manager or member to execute the loan documents; and
 - d. Incumbency Certificate with authorized member's signature.
- G. Mortgage or (Deed of Trust) and Security Agreement
1. MORTGAGE (OR DEED OF TRUST). Must be a first lien on the entire property. Where permitted by local and state law and by the Section of the Act under which the project is insured, e.g., Section 232 projects, the property includes all nonrealty equipment and furnishings whether financed by mortgage proceeds or sponsor's funds. The property also includes major kitchen appliances financed from mortgage proceeds in projects insured under other sections of the Act. The Mortgage (or Deed of Trust) Form must be that approved by the Assistant General Counsel for Multifamily Mortgage Insurance.
 2. Security Agreement and Financing Statement. The appropriate Uniform Commercial Code documentation (Chattel Mortgage where applicable) must be used as the

security instrument for nonrealty equipment and furnishings in accordance with State/local requirements. See the Mortgagee's Certificate, paragraph (12). The mortgagor's attorney's opinion should address the situation in which the owner is an out-of-state entity and a Financing Statement needs to be filed in the entity's home state.

- a. The documents must be filed and/or recorded as specified by State/local law, which may include: the appropriate local court, Secretary of State, State corporation commission, etc.
 - b. Attach a property description (list(s) of major movable equipment) to the financing statement covering all the nonrealty equipment and furnishings covered. Furnishings do not need to be identified individually or with identification or serial numbers, unless it is customary in the jurisdiction to do so.
 - c. The legal description attached to the financing statement should be identical with that used in the Regulatory Agreement, Building Loan Agreement, mortgage, and other closing documents especially the title policy and survey.
3. Liens. The property, including any non-realty equipment and furnishings covered by the mortgage, must be free and clear of all liens other than the insured mortgage and any other liens that HUD approves.
 4. Standard Exculpatory Language for the Mortgage (or Deed of Trust).

"Notwithstanding any other provision contained herein or in the Note, it is agreed that the execution of the Note shall impose no personal liability upon the mortgagor for payment of the indebtedness evidenced thereby and in the event of a default, the holder of the Note shall look solely to the property subject to this Mortgage and to the rents, issues and profits thereof in satisfaction of the indebtedness evidenced by the Note and will not seek or obtain any deficiency or personal judgment against the mortgagor except such judgment or decree as may be necessary to foreclose or bar its interest in the property subject to this Mortgage and all other property mortgaged, pledged, conveyed or assigned to secure payment of the Note; provided, that nothing in this condition and no action so taken shall operate to impair any obligation of the mortgagor under the Regulatory Agreement herein referred to and made a part hereof."

H. Mortgage (Deed of Trust) Note. The Mortgage (Deed of Trust) Note must be in the form approved by the Assistant General Counsel for Multifamily Mortgage Insurance. The section of the Act under which the mortgage is insured should be identified on the panel of the Note.

1. Term must be the same as included in the firm commitment, as long as the maximum and minimum term set out in the commitment meet the following requirement:
 - a. New construction or substantial rehabilitation projects--term may not exceed the lesser of 40 years or 75 percent of the project's remaining economic life.
 - b. Existing project (insured under either Section 207 or Section 232 pursuant to Section 223(f))—term must not be less than 10 years nor exceed the lesser of:

- (1) 35 years, or
 - (2) 75 percent of the estimated remaining economic life of the physical improvements.
 - c. The Note term starts on the date of the originally scheduled commencement of amortization.
2. Prepayment Provisions. Except as specifically permitted in paragraph c, d, and f below, and subject to the conditions in Paragraph 3 below, the Note must contain the following prepayment provisions:
- a. Proprietary (For-Profit) Facilities.
 - (1) Prepayment must be permitted in whole or in part so long as 30 days advance written notice is given to the mortgagee of intent to prepay, except as provided in paragraph H.2.f below.
 - (2) Prepayments must be permitted for up to 15 percent of the original principal amount in any one calendar year without a prepayment charge. Prepayments exceeding 15 percent may be subject to a charge agreed to by the mortgagor and mortgagee and included in the mortgage.
 - b. Nonprofit Facilities.
 - (1) Upon prior consent of the Commissioner, the mortgage debt may be prepaid in full.
 - (2) The Commissioner may approve partial payments to reduce succeeding monthly payments over the remaining portion of the original mortgage term.
 - (3) The Commissioner may also approve partial prepayments made after 30 days written notice. Prepayments exceeding 15 percent of the original principal amount may be subject to a reasonable charge on such excess agreed to by the mortgagor and mortgagee and included in the mortgage.
 - c. State and Local Bond Financed Projects. Subject to compliance with paragraph 3 below, projects funded from tax-exempt or taxable bonds issued by State or local governmental bodies may include the following prepayment restrictions and prepayment penalty charges:
 - (1) Prepayment restriction period (lockout) must not exceed 10 years plus the construction period stated in the construction contract, or, in the alternative, must not exceed 10 years from the commencement of amortization, and
 - (2) Prepayment penalty may be charged after expiration of the lockout stated in paragraph (1) above, provided the charge:
 - (a) During the first year following the lockout does not exceed 5 percent of the original mortgage,
 - (b) Declines on a graduated basis (to the extent practicable, the decline in the penalty percentage should be the same each year), and
 - (c) Does not exceed 1 percent at the end of the fifth year following the lockout.

- d. Other Bond Obligations or GNMA Mortgage-Backed Securities. "Other bond obligations" refers to any agreement under which the insured mortgagee has obtained the mortgage funds from third party investors and has agreed in writing to repay such investors at a stated interest rate and in accordance with a fixed repayment schedule. Mortgages funded with the proceeds of GNMA Mortgage-Backed securities or "other bond obligations acceptable to HUD" may include the following prepayment restrictions and prepayment penalty charges, subject to compliance with paragraph 4 below:
- (1) A lockout not to exceed 10 years plus the construction period stated in the construction contract, or in the alternative, not to exceed 10 years from the commencement of amortization; or
 - (2) A penalty charge provided the charge:
 - (a) Does not exceed 10 percent at the end of the first year following the construction period stated in the construction contract or the date of amortization,
 - (b) Declines on a graduated basis, and
 - (c) Does not exceed one percent at the end of the 10th year following the construction period stated in the construction contract.

If the initial penalty is 3% or less the HUD override language in paragraph 3 below, is not required; the penalty can be as great as 10% if the override language is included; or
 - (3) A combination lockout and penalty charge in which:
 - (a) The lockout period does not exceed 10 years plus the construction period stated in the construction contract, or in the alternative, 10 years from the commencement of amortization, and
 - (b) The prepayment penalty does not exceed 1 percent at the end of the tenth year following the construction period stated in the construction contract or commencement of amortization.
- e. Mortgages containing both bond financing, other than state or local government, and GNMA Mortgage-Backed Securities may be subject to both a lockout provision and a penalty charge as set out in H.2.d above.
- f. Other Mortgages: Prepayment lockout provisions are not permitted, except where required by HUD regulations to hold certain types of rentals available, e.g., for Section 223(f). (See Paragraph 12.4.5)
- g. Those prepayment provisions which are preprinted in the Note may be deleted if the Guide authorizes alternative provisions which supersede the printed provisions.
3. Conditions For Including Lock-outs and/or Penalties. Compliance with the following conditions is required when prepayment lockouts and/or penalties are permitted.

Rider to the Note. The following language must be included, allowing HUD to override the prepayment lockout and/or penalty provisions in the event of a default:

Notwithstanding any prepayment prohibition imposed and/or penalty required by this Note with respect to prepayments made prior to _____, 20__, [enter first date on which prepayments may be made with a penalty of 1 percent or less] the indebtedness may be prepaid in part or in full on the last or first day of any calendar month without the consent of the mortgagee and without prepayment penalty if HUD determines that prepayment will avoid a mortgage insurance claim and is, therefore, in the best interest of the Federal Government."

Use of the above rider to the Note is a condition of permitting lockouts for "State and Local Bond Financed Projects," paragraph H.2.c above, "Other Bond obligations or GNMA Mortgage-Backed Securities," paragraph H.2.d above, and for prepayment penalties that initially exceed 3 percent in any project.

Mortgagees may add the following:

HUD would consider exercising an override of a mortgagee's prepayment lock-out and/or penalty provision only if the following conditions are met:

- (1) The project mortgagor has defaulted and HUD has received notice as required by the regulations;
 - (2) HUD determines that the project has been experiencing a net income deficiency, which has not been caused solely by management inadequacy or lack of owner interest, and which is of such a magnitude that the mortgagor is currently unable to make required debt service payments, pay all project operating expenses and fund all required HUD reserves;
 - (3) HUD finds there is a reasonable likelihood that the mortgagor can arrange to refinance the defaulted loan at a lower interest rate or otherwise reduce the debt service payments through partial prepayment; and
 - (4) HUD determines that refinancing the defaulted loan at a lower rate or partial prepayment is necessary to restore the project to a financially viable condition and to avoid a full insurance claim.
4. Late Charge Provisions. The mortgagee may collect a late charge for the cost of handling delinquent payments, subject to the following:
- a. Charges must not exceed two cents per dollar of principal and interest more than 15 days in arrears.
 - b. Late charges must be separately charged to and collected from the mortgagor and cannot be deducted from any total monthly mortgage payment, or collected from any reserve escrow, residual receipts funds, or from any interest accruals thereto.
5. Standard Exculpatory Language for the Mortgage (or Deed of Trust) Note.

Notwithstanding any other provision contained in this Note, it is agreed that the execution of this Note shall impose no personal liability on the maker hereof for payment of the indebtedness evidenced hereby and in the event of a default, the holder of this Note shall look solely to the property described in the Mortgage and to the rents, issues and profits therefore in satisfaction of the indebtedness evidenced hereby and will not seek or obtain any deficiency or personal judgment against the maker hereof except such judgment or

decree as may be necessary to foreclose and bar its interest in the property and all other property mortgaged, pledged, conveyed or assigned to secure payment of this Note except as set out in the Mortgage of even date given to secure this indebtedness."

- I. Second Mortgages. Secondary financing is permitted to evidence repayment of (i) a Federal, State or local government agency or instrumentality loan or (ii) a loan from a nongovernmental source, subject to compliance with the requirements set forth in Chapter 8 herein, including the use of the Secondary Financing Rider, which must be attached to the note, and, where applicable, to the mortgage used for any secondary financing. Before scheduling the closing, the HUD closing attorney must review the grant/loan documents to assure their legal sufficiency.
 1. Grants or loans from Federal, State or local government agencies.
 - a. If the grant/loan funds are not available at initial endorsement, HUD may proceed to closing but not disburse any mortgage proceeds until the grant/loan is in place and the funds are available or have the mortgagor fund an escrow equal to the grant/loan, disbursements from which must be made in accordance with instructions for disbursement of the grant/loan.
 - b. Terms of the second mortgage note also must reflect those provisions found in Forms FHA-1710 and 2223, depending upon type of mortgagor. (Form FHA-2223 is applicable to for-profit mortgagors.) (See Paragraph J below.)
 2. Grants or loans from nongovernmental source.
 - a. The grant/loan funds must be escrowed with the mortgagee before or at initial endorsement.
 - b. The grant/loan must be disbursed before the mortgage proceeds.
 - c. Release of grant/loan proceeds cannot be geared to the completion of specific improvements.
 - d. Terms of the second mortgage note must also reflect those provisions found in Forms FHA-1710 and 2223, depending on the type of the mortgagor.
- J. Unsecured Promissory Notes.
 1. Unsecured Promissory notes are used to evidence a debt of the mortgagor entity incurred as a result of the development of an insured multifamily project and must receive HUD approval prior to their issuance. Promissory notes are also called surplus cash notes or residual receipts notes.
 - a. Promissory notes are used to evidence the following types of debt:
 - (1) Discounts, financing fees, and/or extension fees paid by a third party on behalf of the mortgagor entity.
 - (2) A secondary loan from a government or nongovernmental source.

- (3) Deferment of the general contractor's profit in return for the mortgagor's agreement to pay upon completion of the project:
 - (a) Such arrangements must be disclosed by the parties before initial endorsement.
 - (b) Such arrangements are permitted only under those sections of the National Housing Act that do not provide for BSPRA.
 - (4) Amount by which the land acquisition cost exceeds HUD's warranted price of land fully improved.
 - b. Promissory notes are not to be executed for costs disallowed in the cost certification review.
 - c. Promissory notes are not executed to determine the distribution of surplus cash, nor are they issued to establish an equity interest.
2. Development Staff Duties. To coordinate the identification and handling of development-related liabilities and expenditures:
- a. The Hub Director is responsible for approving the issuance of a promissory note before final endorsement.
 - b. The Hub Director will prepare a list of all promissory notes approved before the final endorsement of the mortgage. The list must include the name of the payee, the amount and the reason for the issuance.
 - c. Prepayment of the promissory notes from sources other than the project is permitted without HUD approval.
 - d. Payments for promissory notes will be made only as indicated in the applicable Regulatory Agreement.
3. Type of Promissory Note Used depends of the type of mortgagor entity and the Regulatory Agreement.

a.

Entity	Use
1. Nonprofit Entities	Residual Receipts Note, Form FHA-1710
2. All other Entities	Promissory Note, Form FHA-92223

b. Form FHA-1710, Residual Receipts Note (Nonprofit Mortgagors).

- (1) Principal and interest shall be due and payable on or after the maturity date of the HUD insured mortgage.
- (2) If the HUD insured mortgage is prepaid in full, the holder of the residual receipts note has the right to declare the whole principal sum or any balance with interest immediately due and payable.

- (3) Prepayment to principal and interest may be made only from the residual receipts fund as defined in the Regulatory Agreement and only after obtaining written approval from HUD or from sources other than project income, e.g., syndication proceeds.
 - (4) Prepayments may be made only after final endorsement of the insured mortgage and after a semiannual or annual fiscal period.
 - (5) Any unauthorized prepayment accepted by the payee must be held by the payee in trust for the project.
 - (6) The residual receipts note is nonnegotiable and may not be sold, transferred, assigned, or pledged by the payee except with the prior written approval of HUD.
 - (7) Presentation, demand and notice of demand, nonpayment and protest of the residual receipts note are waived.
 - (8) Interest on the note must not be compounded.
- c. Form FHA-92223, Promissory Note, (All other entities). Conditions and limitations are the same as Form FHA-1710, except that:
- (1) Provisions may be made for interest payments only semiannually or at the end of a fiscal period. However, terms of the note should include the fact that interest accrues and is payable in full when the note matures.
 - (2) Prepayment of principal or any payment of interest must be limited to surplus cash as defined in the Regulatory Agreement or from sources other than project income, e.g., syndication proceeds.
 - (3) Any unauthorized prepayments, as determined by HUD, shall be the responsibility of the payor to return to the project.
- d. FHA Form-1212.
- e. The interest rate on the promissory note is negotiable between the payee and payor.
- f. The HUD closing attorney may approve the modification of the HUD form promissory notes to more closely represent the requirements of the specific closing. The HUD closing attorney may also, if appropriate, approve the use of a promissory note on other than the HUD form as long as the necessary HUD required language is placed in the non-HUD note.
- K. Regulatory Agreement must be incorporated into the mortgage by reference.
1. The Regulatory Agreement must be on a form approved by HUD for use by the mortgagor. The Agreement establishes the mortgagor's obligations in project operations and HUD's rights if the Agreement is violated.
 2. For a Section 232 assisted living project, the Regulatory Agreement should state that the facility is being designed/developed as an assisted living facility for the frail elderly (62 years or older and require assistance with three or more activities of daily living).

3. Where a Section 232 project is leased to a nursing home operator, the lessee must also execute a Regulatory Agreement, Form-92466-NHL.
4. Additional restrictions may be imposed by the Multifamily Hub Director with prior approval from the Headquarters Office of Business Products and Assistant General Counsel for Multifamily Mortgage Insurance, where the additional requirements do not conflict with program criteria. These requirements will be set out in the commitment.
5. The individual(s) authorized to act on behalf of the mortgagor will execute the appropriate form of the Regulatory Agreement.

12.1.5

Construction Contract and Other Construction Documents

- A. Construction Contract. See Chapter 13 and the Forms Book. Note that the contractor must be licensed to do business in accordance with the requirements of the state where the project is being constructed. HUD staff must assure that HUD Form-2554 “Supplementary Conditions of the Contract for Construction” and the current applicable wage decision are included in the specifications. HUD staff must confirm with Labor Relations that the Davis Bacon prevailing wage decision is current (use e-mail, fax, or phone if Labor Relations staff is not on-site).
- B. Construction Contract Incentive Payment. Construction Contract Incentive Payment is an option that the mortgagor may elect to use, at its sole discretion, as a contractor inducement for early contract completion. It may not, however, be added to the construction contract after initial endorsement. The Forms Book contains additional instructions.
- C. Early Start/Start of Construction. Construction may not start before initial endorsement and recordation of the insured mortgage, except with the prior approval of the Multifamily Hub Director pursuant to the early start procedures. (See Forms Book.)
- D. Owner – Architect Agreement. Owner – Architect Agreement must be on AIA Document B181, Standard Form of Agreement Between Owner and Architect for Housing Services 1994 Edition, and the HUD Amendment, Appendix 12-B2, must be included as a rider. See Appendix 12B1 for additional information.
- E. Assurance of Completion. All types of assurance of completion must be on HUD approved forms.
 1. Except for Letters of Credit, the HUD closing attorney must review each type of assurance of completion, including the form of bonds where used, for legal sufficiency and compliance with applicable State requirements.
 2. Letters of credit may be used instead of cash for all assurances of completion and escrows required at initial and final endorsement, or during construction, except for up-front cash escrows and Section 223(f) repair escrows.

- a. Acceptance of a letter of credit is at the mortgagee's option. However, the letter of credit must always be:
 - (1) Unconditional and irrevocable.
 - (2) Issued by a banking institution.
 - (3) Valid and collectible.
 - b. The mortgagee may not be the issuer of any letter of credit without prior written consent of the Hub Director.
 - c. HUD will neither look at the letter of credit nor render an opinion as to its enforceability or acceptability at closing, as enforceability and acceptability is the mortgagee's sole responsibility.
- F. Assurance of Completion for On-Site Improvements. Assurance of completion for on-site improvements must be provided by the general contractor for HUD's protection and to meet State/local requirements to protect material suppliers and mechanics or to assure contractor or subcontractor payment. See requirements of Mortgagee's Certificate, paragraph (9). The mortgagee or mortgagor may impose higher requirements, but must require one of the following as a minimum:
1. Corporate surety bonds. Form FHA-2452 should be used for payment bonds and Form FHA-2452A for performance bonds, each equaling 100 percent of the HUD estimate of the total for all improvements (Line 53, FHA 2328). Corporate surety bonds are required for the assurance of completion of on-site improvements where payment for components stored offsite is approved.
 - a. Surety must be on the accredited U.S. Treasury list, Circular 570, published annually in the Federal Register on or about July 1 (The list is also available at www.fms.treas.gov/c570/c570.html).
 - b. The bonds must not exceed limits listed in Circular 570.
 - c. HUD and mortgagee must be shown as payee as their interests appear. GNMA may also be named if GNMA securities are being issued.
 - d. An original power-of-attorney must be attached to each Performance and Payment Bond and dated the same day as both the Bonds.
 - e. A facsimile transmission addressed to the HUD closing attorney must be received in hand on the day of closing from surety's headquarters (not local office) confirming the agent's power-of-attorney to bind surety as of the date the bonds are executed. The facsimile transmission should identify the agent, date of bonds, amount of each bond, obligee(s), principal, FHA project name and number, and name and title of sender.

2. Completion assurance agreement. Use Form HUD-92450, secured by a cash deposit (or unconditional, irrevocable letter of credit) for the appropriate percentage of the HUD estimate of construction or rehabilitation cost, as described below:
 - a. Small Projects and Walk-up Financing: HUD requires a deposit of 15 percent of the HUD estimate of construction or rehabilitation cost for projects meeting the following criteria:
 - (1) Structure contains no elevator, or
 - (2) Structure contains an elevator but is three stories or less.
 - b. Large and Elevator Projects: HUD requires a deposit of 25 percent of the HUD estimate of construction or rehabilitation cost for projects meeting the following criteria:
 - (1) Structure includes an elevator, or
 - (2) Structure is four or more stories.
 3. Mortgagor-contractor without construction contract. Require assurance of completion as defined in paragraphs 12.1.5.F above, except if corporate surety bonds are used, substitute Form FHA-3452 for Form FHA-2452 and substitute Form FHA-3452A for Form HUD-92452A.
 4. HUD cost estimate for determining surety amount. Use the following guidelines in computing the HUD cost estimate for use in paragraph F.1 above:
 - a. BSPRA projects.
 - (1) Deduct the architect's fee from the "total for all improvements," Form HUD-92264, Line 50.
 - (2) Add to the amount computed in step a.(1), a typical builder's profit, but no general overhead.
 - b. Non BSPRA projects: Use only step a.(1) above.
- G. Assurance of Completion for Off-Site Improvements. See requirements of Mortgagee's Certificate, paragraphs (7) and (8). To assure completion of the work, which may not be financed with mortgage proceeds, one of the following is required:
1. Public Body Agreement acceptable to HUD from the controlling jurisdiction giving assurance for installation of utilities, streets or other facilities without cost to the mortgagor. A mortgagor's attorney's opinion that the agreement is binding on the public body and succeeding administrations is required.
 2. Cash Escrow (use Form FHA-2446, Escrow Agreement for Offsite Facilities) deposited with the mortgagee, a trustee or an escrow agent acceptable to HUD, or an unconditional irrevocable letter of credit (see paragraph 12.1.5.E). The amount must equal or exceed HUD's estimate of cost of offsite facilities.
 3. Retention of Specified Mortgage Proceeds By Mortgagee may be used only when cash available to the mortgagor, as shown in line 42 of Form FHA-2283, equals or exceeds the

estimated offsite construction costs plus the lesser of HUD's as is estimate of value, or the actual latest arm's length purchase price. Where additional assurance is deemed necessary by the Hub Director, one of the following will be required:

- a. Form FHA-2479, Offsite Bond, or
- b. A letter of credit in accordance with paragraph 12.1.5.E above.

H. Hazard Insurance Policy

1. The mortgagee is responsible for insurance compliance per the Mortgagee's Certificate, paragraph 17. Mortgagor must provide hazard insurance and the policy(ies) must contain a loss payable clause with the mortgagee and the contractor named as their interests may appear. HUD will not review the Hazard Insurance Policy. The mortgagor may elect or the mortgagee may require a higher amount, but the insurance must at least equal 100 percent of the replacement value of structures as determined by HUD.
2. Property Insurance Requirements and Schedule. Mortgagee must provide to the mortgagor an original and one copy of Form FHA-2447, Property Insurance Requirements with Form HUD-92329, Property Insurance Schedule-Insurable Values for Property Insurance Coverage attached. The mortgagee is solely responsible for determination of whether the insurance requirements set forth in Form 2447 have been satisfied. There is no need for HUD to either review or obtain the policy itself.
3. Effective Coverage Date. Pursuant to the Property Insurance Requirements, Form FHA-2447, the property insurance should bear the Mortgage (or Deed of Trust) Note date.

I. Building Loan Agreement Form HUD-92441

See Mortgagee's Certificate, paragraphs (2), (3), and (5). Set out the responsibilities, conditions, and operating terms between the mortgagee and mortgagor, including the basis under which insured advances may be made during the construction period. Also use the Supplement to Building Loan Agreement, Form FHA-2441-SUP, where an Owner-Contractor does not use a construction contract. See Appendix 12-I.

J. Mortgagee's Certificate Form FHA-2434

All required escrows, deposits, fees and other amounts must be properly reflected in the Mortgagee's Certificate as well as information concerning other bond obligations, extension fee agreements and permanent loan commitments. The Hub Director is responsible for determining that the financial amounts are correct.

K. Agreement and Certification Forms HUD-3305 and 3306 obligate the mortgagor to certify its actual costs of project construction or rehabilitation costs and to disclose any identity of interest among project participants.

- L. Collateral Agreements. The mortgagor is required to submit with the closing package, signed duplicate copies for any collateral agreements needed to cover unusual conditions affecting construction of the project including actions of the principals of the mortgagor entity and any other agreements not involving HUD. These agreements cannot alter or amend HUD documents or alter the obligations of the parties there under without the written approval of the Hub Director.

12.1.6**Additional Closing Requirements**

- A. Working Capital Deposit. HUD requires a cash escrow or letter of credit of not less than 2 percent of the mortgage (lender may require more) at initial endorsement for all mortgagors. See the Mortgagee's Certificate, Paragraph 6.
- B. Assurance of Funds to Meet Operating Deficits
1. Funding of any operating deficit projected on Form HUD-92264, including (where applicable to the program, e.g., Section 232 projects) equipment and supply purchases is required from other than mortgage proceeds. The operating deficit escrow is established in accordance with chapter 7. Mortgagor must supply funds as a firm commitment condition to meet project expenses during the HUD estimated period required to establish a sustaining level of operation. See the Mortgagee's Certificate, paragraph (10).
 2. Funding may be an:
 - a. Agreement of Sponsors to Furnish Additional Funds, Form FHA-2476, accompanied by Bond Guaranteeing Sponsor's/mortgagor's Performance, Form FHA-2477. The bond must equal the sum required to be deposited in Form FHA-2476, or
 - b. Additional Contribution by Sponsors/Mortgagors, Form HUD-92476A. The required amount may be: a cash escrow, United States Treasury securities or securities issued by a federal agency with a market value equal to 115 percent of the required amount of the escrow, or an unconditional and irrevocable letter of credit.
 - (1) The Hub Director must review the escrow agreement for sufficiency and the closing attorney must review it for legal acceptability.
 - (2) If excess mortgage proceeds are used for the cash escrow:
 - (a) A letter of credit for the operating deficit may not be accepted at initial endorsement.
 - (b) A mortgagee's statement acknowledging that it must receive HUD's written approval before making any disbursements from the escrow account is required.
- C. Sponsor's Guarantee Agreement. See Mortgagee's Certificate, paragraph (11). Section 232 Board and Care projects with independent living facilities require a 12-month debt service reserve in addition to any required operating deficit escrow. See Chapter 8 for additional details on the debt service reserve.

D. Discounts, Financing Fees, and Issuance Costs. See Mortgagee's Certificate, paragraphs (18)b through (18)f. Loan fees, including: discounts, permanent loan discounts, financing fees, bond issuance costs, and similar charges (fees) to be collected by/through the mortgagee and listed on the Mortgagee's Certificate, Form FHA-2434, and the required attachment explaining why each charge is needed to issue the obligations will be reviewed.

1. The Mortgagee will be informed in writing of the aggregate amount that will be allowed at cost certification for discounts, financing fees and issuance costs, stated as a definite percentage of the mortgage. Reflect the percentage that will be recognized at cost certification in the margins of Form FHA-2434.

The amount cannot exceed 3-1/2 percent of the mortgage. However, an additional 2% of the mortgage amount can be recognized at cost certification for costs required for bond obligations, where the sponsor/mortgagor can't benefit monetarily from excess investment income or the proceeds from tax-exempt obligations for a total allowed of 5-1/2%.

2. The Mortgagee's Acknowledgment of the additional costs that HUD will allow at cost certification will be required on a copy of HUD's letter to the mortgagee, and will be filed with the Mortgagee's Certificate for use in reviewing the cost certification.

3. Dates Loan Fees Are Earned are as follows:

- a. Construction loan fees are earned at initial closing, except for any portion that the loan documents provide for payment at a later date. Construction loan extension fees are not earned until the time such extensions are made.
- b. Permanent loan fees, and permanent loan extension fees are earned at final closing. A permanent loan in this instance is a loan separate and distinct from the construction loan, and for which the proceeds are used to pay off the construction loan.
- c. Unitary loan fees are earned at initial closing, except for any portion that the loan documents provide for payment at a later date.

(1) A unitary loan is one where the loan and involvement of the investors spans both the construction and permanent phases of the loan, so that the construction and permanent loans represent one transaction.

(2) Where the loan documents approved by HUD provide for a "discount," "permanent discount," "marketing fee," or "bond underwriting fee" (fee), whether in a lump sum, discounted advance, or other basis, and under the terms of its agreement with its investors or participants, or with its broker, the mortgagee is obligated to pay the fee at any time prior to the date of assignment of the mortgage to HUD in order to receive insurance benefits, HUD will not surcharge the insurance claim by the amount of such fee.

E. Fee Payment from Cash Available to Mortgagor. See Mortgagee's Certificate, paragraph (18).

1. Fees Paid At Initial Closing. Excess mortgage proceeds may be used to pay construction and permanent loan discounts, including that for unitary loans, bond issuance costs, and GNMA indemnification escrow at initial closing to the extent recognized by HUD under

paragraphs (18)b through (18)e of the Mortgagee's Certificate, where loan documents approved by HUD provide for the payment of such fees at initial closing.

2. Fees Paid After Initial Closing, Excess mortgage proceeds may be used to fund permanent loan discounts, including that for unitary loans, and construction and permanent loan extension fees for payment after initial closing to the extent recognized by HUD under paragraphs (18)b, c, d and f of the Mortgagee's Certificate, where loan documents approved by HUD provide for the payment of such fees after initial closing, subject to the following:
 - a. The mortgagee is required to escrow sufficient funds in mortgagor's behalf to cover fees approved under the Mortgagee's Certificate, paragraphs (18)b, c, d and f, for payment after initial closing,
 - b. The mortgagor is required to furnish a written agreement to HUD that any disbursements from the escrow accounts must require HUD's written approval,
 - c. A Letter of Credit will not be accepted at initial closing for any of the amounts to be satisfied from excess mortgage proceeds, and
 - d. Such escrowed excess mortgage proceeds may be released when earned per paragraph 12.1.6.D.4 of this Guide.
- F. Deferred Fee Collection. Where the mortgagee, bond underwriter or issuer may exercise the option for deferred collection of discounts, financing fees, etc., permitted by paragraph 18.f of the Mortgagee's Certificate, the deferred collection of these items must be an obligation of a third party.
1. Third Party Obligees, and the mortgagee, bond underwriter or issuer, must attest in writing that they will not look for payment from the: mortgagor, mortgaged property, mortgage proceeds, any reserve or deposit required by HUD in connection with the mortgage transaction, or rents or other income from the mortgaged property. Use Appendix 12D, Specimen - Third Party Obligee Certification, for the purpose.
 2. Promissory Note. The certifications in paragraph F(1) above may not be binding on any party except the mortgagee in certain instances. Therefore, two conformed copies of a promissory note are required at initial closing for which:
 - a. The maker must be the third party obligated for payment of the fee,
 - b. The form and content must be satisfactory to the maker and mortgagee,
 - c. The note may be unsecured or secured by pledging of specific assets, except that the assets must be completely separate from the mortgaged property or assets held in connection with it or its operation, including rental income and escrow accounts, and
 - d. The note must include the following statement on its face.

"It is a condition of this note that the payee or any subsequent holder hereof may not assert any claim arising from this note against the following assets of the maker:

The interest of the maker in property located at _____ and covered by a mortgage insured by HUD under Project No. _____ or deposit

made with the mortgagee or another required by HUD in connection with the mortgage transaction or the rents or other income from the property."

- e. The mortgagor entity may issue to the third party obligated for future fees payment a residual receipts note or surplus cash note as evidence of the promissory note debt. In such event, use:
 - (1) Form FHA-1710, Residual Receipt Note, for non-profit mortgagors,
 - (2) Form FHA-2223, Promissory Note, for all other mortgagors.

G. Broker's Fees. See Mortgagee's Certificate, paragraph (20).

1. Referral fees are prohibited in every instance.
2. Mortgagee may not pay anything of value directly or indirectly to any person or entity in connection with an insured transaction if the person or entity has received any other compensation from the mortgagor, seller, builder or any other person for services related to the transaction, or related to the purchase or sale of the mortgaged property, except as described in paragraph G(3) below.
3. The Hub Director may approve compensation for services actually performed, where:
 - a. The function must be performed in any event.
 - b. The services are actually rendered and payment is reasonable and customary.
 - c. The broker's fee is included on the Mortgagee's Certificate, and
 - d. The mortgagor submits a separate letter to HUD identifying the fee paid, the name of the broker, the reasons why it was necessary to employ a broker, and certifying that there is no identity of interest between the mortgagor/sponsor and the broker, or between the mortgagee and the broker. The Multifamily Hub Director must indicate approval of the fee in writing.

H. Mortgagor's Certificate. The mortgagor's certificate obligates mortgagor to comply with various requirements, including civil rights, during the insured period. In addition, mortgagors of Section 232 projects must certify at endorsement (initial and final endorsement for insurance of advances) that:

1. The mortgage is a first lien and covers the entire project, including the equipment financed with mortgage proceeds.
2. The property upon which the improvements have been made or constructed and the equipment financed with mortgage proceeds are free and clear of all liens other than the HUD-insured mortgage and such other liens as may be approved by HUD.
3. The certificate sets forth all unpaid obligations in connection with the mortgage transaction, the purchase of the mortgaged property, the construction or rehabilitation of the project or the purchase of the equipment purchased with mortgage proceeds.

I. Mortgagor's Attorney's Opinion

1. The mortgagor's attorney must submit a comprehensive opinion with the closing package in a format acceptable to HUD, addressed to HUD, the mortgagee, and the mortgagee's attorney as to the legal sufficiency of the security instruments, and collateral agreements affecting the mortgagor entity or project.
2. It also must include the following, as applicable:
 - a. If the mortgagor is a Limited Liability Company (LLC), the mortgagor's attorney's opinion must be modified to include:
 - (1) Opinion to the authority of the LLC's managing members or non-member manager, under applicable state laws and the LLC's organizational documents, to execute and perform under the terms of the Regulatory Agreement, Note and Mortgage.
 - (2) Opinion that the LLC is qualified to hold title to real property and transact business in the property jurisdiction if the property jurisdiction is not the state of formation of the LLC.
 - b. Any substantive changes to the HUD Forms, if approved by HUD pursuant to 12.1.4.A or B,
 - c. The opinion required by Section 12.1.5.G.1, herein,
 - d. The opinion required by Section 12.1.10.B, herein.

12.1.7

Initial Endorsement of Credit Instrument

The Hub Director, after consultation with other HUD staff, including the HUD closing attorney, is fully authorized to initially endorse the credit instrument (Mortgage/Deed of Trust Note) after the First Year's Mortgage Insurance Premium and Inspection Fee have been received and after concluding that all requirements for closing have been met.

12.1.8

Revision of Closing Forms and Documents

After closing and initial endorsement of the credit instrument, the closing forms and documents may not be revised or amended without the prior approval of the Hub Director.

12.1.9

Local Rent Restrictions

Local rent restrictions are not permitted to be placed in the deed covenants or other closing documents, where a municipality wishes to implement affordability rent restrictions pursuant to a Comprehensive Housing Affordability Strategy (CHAS) plan or other initiative, except where

significant financial assistance is approved such as in the form of tax-exempt bonds, CDBG, HOME funding, Low Income tax Credit or land write down:

- A. Where rent restrictions are approved, the Mortgagor's Attorney's Opinion must be consistent with Paragraph 12.1.10.B for tax-exempt bond financing, except the type of state/local financial assistance should be substituted for "tax-exempt bonds" where applicable,
- B. Where rent restrictions are approved, the Mortgagee's Attorney's Opinion must be consistent with Paragraph 12.1.10.C for tax exempt bond financing, except substitute the type of state/local financial assistance for "tax-exempt bonds" where applicable,
- C. Where rent restrictions are approved, the HUD closing attorney must review the provisions relating to rent restrictions in accordance with provisions for tax-exempt bond financing, Paragraphs 12.1.10.C and D.

12.1.10

Tax Exempt Bonds

Projects financed with the proceeds from tax-exempt bonds pursuant to the Internal Revenue Code, Section 142d, must meet minimum low income occupancy restrictions to exempt the earned interest income from Federal income taxation. Such projects typically contain special deed covenants and other recorded restrictions to assure owner compliance with its occupancy and use requirements.

- A. Low-Income Occupancy Requirements. The mortgagor must include with the initial closing review package the bond issuer's or bond counsel's certification indicating which of the occupancy restrictions will be imposed on the project. HUD will review the closing documents only to determine that they do not conflict with HUD occupancy or other requirements.

The IRS Code requires that:

1. Owners of residential rental projects must either meet the 20-50 test or the 40-60 test, e.g., set aside a minimum of either:
 - a. Twenty percent of the units for occupancy by individuals whose income is 50 percent or less of the area median gross income (with adjustments for family size) for the term of the qualified project period (20-50 test), or
 - b. Forty percent (25 percent in New York City) of the units for occupancy by individuals whose median gross income is 60 percent or less of the area median gross income (with adjustments for family size) for the term of the qualified project period (40-60 test).
2. "Qualified Project Period" means the period beginning on the 1st day on which 10 percent of the residential units in the project are occupied and ends on the latest of:
 - a. The date which is 15 years after the date on which 50 percent of the project units are occupied,

- b. The 1st day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or
 - c. The date on which any assistance provided with respect to the project under Section 8 ends.
- B. Mortgagor's Attorneys Opinion Tax-exempt Bond Financing. The following paragraph must be included in the opinion given at closing:

“Any contracts or other documents executed by the mortgagor or any other arrangements agreed to by the mortgagor in order to finance the mortgage with bonds exempt from taxation (and/or tax credits) under provisions of the Internal Revenue Code are consistent with the Mortgage, Mortgage Note, Regulatory Agreement, Building Loan Agreement, Construction Contract, and all other documents executed by the mortgagor and submitted to the lender in connection with the mortgage transaction.”
- C. A Mortgagee's Attorney's Opinion must contain the following certifications ensuring that the project covenants related to the bond financing are consistent with HUD requirements:
 1. The covenants are expressly subordinate to the HUD insured mortgage, e.g., covenant instrument contains a subordination clause;
 2. The covenants will automatically terminate in the event of foreclosure or transfer of title by deed in lieu of foreclosure, e.g., covenant instrument contains an automatic termination clause, (except that the requirements set out in 26 U.S.C. 42(h)(6)(e)(11) that for three years low income tenants may not be evicted and their rents may not be raised, may remain);
 3. Failure to comply with the covenants will not serve as a basis for default on the HUD-insured mortgage;
 4. The covenants do not appear in the Note, Mortgage, HUD Regulatory Agreement, or any other HUD/FHA loan document;
 5. The covenant instrument contains a provision stating that enforcement of the covenants will not result in any claim against the project, the mortgage proceeds, any reserve or deposit required by HUD in connection with the mortgage transaction, or the rents or other income from the property other than:
 - a. Available surplus cash, if the mortgagor is profit-motivated, or;
 - b. Available residual receipts authorized by HUD, if the mortgagor is nonprofit.
 6. The covenant instrument contains a provision making any subsequent amendment contingent on prior written HUD approval, so long as the property is subject to a mortgage insured or held by HUD;
 7. Any provision requiring the owner to take any action necessary to preserve the tax exemption of the interest on the notes or bonds (and/or tax credits) (or prohibiting the owner from taking any action that might jeopardize the tax-exemption (and/or tax credit) is qualified to except actions prohibited (or required) by HUD pursuant to the National Housing Act, applicable mortgage insurance regulations, the HUD/FHA loan documents,

or, if applicable, Section 8 of the U. S. Housing Act of 1937 and the regulations thereunder;

8. The covenant instrument does not conflict with any applicable HUD mortgage insurance or Section 8 regulations; and
 9. The covenant instrument contains the HUD subordination language prescribed in sub-paragraph D below:
- D. HUD subordination language required for every recorded document that contains restrictive covenants:

"Notwithstanding anything in this document to the contrary, except the requirements in 26 U.X.C. 42(h)(6)(e)(11), the provisions hereof are expressly subordinate to the HUD insured mortgage or Deed of Trust, to the HUD Regulatory Agreement, and subordinate to all applicable HUD mortgage insurance (and Section 8, if applicable) regulations and related administrative requirements. In the event of any conflict between the provisions of this document and the provision of an applicable HUD regulations, related HUD administrative requirements, or HUD/FHA loan documents, the HUD regulations, related administrative requirements or loan documents shall control.

In the event of foreclosure or transfer of title by deed in lieu of foreclosure, any and all land use covenants contained herein shall automatically terminate.

Failure to comply with the land-use covenants contained herein will not serve as a basis for default on the HUD insured mortgage.

Enforcement of the covenants herein will not result in any claim against the project, any reserve or deposit required by HUD in connection with the mortgage transaction, or the rents or other income from the property other than:

1. Available surplus cash, if the mortgagor is profit-motivated;
2. Available distributions and residual receipts authorized for release by HUD, if the mortgagor is limited distribution; or
3. Available residual receipts authorized by HUD, if the mortgagor is non-profit.

Any subsequent amendment to this document is subject to prior HUD approval.

No action shall be taken in accordance with the rights granted herein to preserve the tax exemption of the interest on the notes or bonds (and/or tax credits), or prohibiting the owner from taking any action that might jeopardize the tax-exemption (and/or tax credit), except in strict accord with the National Housing Act, applicable mortgage insurance regulations, the HUD/FHA loan documents, or if applicable, Section 8 of the U.S. Housing Act of 1937 and the regulations thereunder."

- E. State/Local Occupancy, Use and/or Rent Restrictions on projects financed by proceeds from their tax-exempt obligations are often more restrictive than the minimum requirements of the Internal Revenue Code. The Hub Director may approve a State or local restriction exceeding the minimum requirements of the Internal Revenue Code, only if the following conditions are met:
1. The Hub Director must determine that the restriction is not likely to have an adverse impact on project occupancy, marketability or long-term feasibility. This determination must be made on a project-by-project basis.
 2. The restriction must not conflict with any applicable HUD mortgage insurance regulations or related administrative requirements.
 3. The restriction must not appear in the note, mortgage, HUD Regulatory Agreement or any other HUD/FHA loan document.
 4. The restriction must be qualified to provide that it will automatically terminate in the event of foreclosure or transfer of title by deed in lieu of foreclosure. Such a termination provision must be included in every legal instrument (e.g., deed, land use restriction agreement, Regulatory Agreement, or financing agreement) in which the restriction appears.
 5. Every legal instrument containing the restriction must include the following provisions:
 - a. "Enforcement of the provisions of this instrument will not result in any claim against the project, the mortgage proceeds, any reserve or deposit required by HUD in connection with the mortgage transaction, or the rents or other income from the property (other than available surplus cash)." For cases involving limited distribution mortgagors, substitute "available distributions and residual receipts authorized for release by HUD" for "available surplus cash."
 - b. "Notwithstanding anything in this instrument to the contrary, the provisions hereof are subordinate to all applicable HUD mortgage insurance regulations and related administrative requirements. In the event of any conflict between the provisions of this document and the provisions of any applicable HUD regulations, related HUD administrative requirements, or HUD/FHA loan documents, the HUD regulations, related administrative requirements or loan documents shall control."
 6. Rent restrictions must be in a form that permits the Field Office to make meaningful income estimates for the units subject to the restriction. For example:
 - a. A restriction that limits the rent for a low or moderate income unit to a percentage of the actual tenant's income (an unknown amount at the time of HUD processing) is unacceptable.
 - b. A rent limit based on a specified percentage of some recognized standard (e.g., 30 percent of 80 percent of the area median income or 120 percent of the Section 8 Existing FMR) may be acceptable.
- F. Underwriting Review. The legal instruments, e.g., deed, land use restriction agreement, tax regulatory agreement, etc., containing tax exempt financing required covenants must be reviewed by HUD prior to initial closing for any effect on the mortgage insurance underwriting.

12.1.11**Low Income Housing Tax Credits**

Tax credit provisions included in the Tax Reform Act of 1986 were designed to encourage owners to make rental housing units available to low income households at affordable rents. Where projects contain special deed covenants or other recorded provisions to assure owner compliance with occupancy and rent restrictions for tax credit eligibility, the mortgagor and mortgagee must comply with the following:

- A. Mortgagor's Attorney's Opinion—Tax Credits must be on the attorney's letterhead and state as provided in Paragraph 12.1.10.B, except that where the term "tax exempt bonds" occurs, substitute the term "tax credits."
- B. Mortgagee's Attorney's Opinion must address the legal instruments as to the acceptability of any covenants. Covenants required for tax credits are permitted on an insured project only as provided in Paragraph 12.1.10.C for tax exempt bonds.
- C. Low Income Occupancy and Rent Requirements.
 1. For a minimum of 15 years the owner must assure occupancy that meets the same low-income occupancy restrictions as in either Paragraph 12.1.10.A.2.a or b, whichever the owner selects.
 2. Gross rents, inclusive of utility costs, for the project's low-income units may not exceed 30 percent of the applicable qualifying low-income limit, adjusted for family size.
 3. The Hub Director may not endorse the note for any project unless all requirements of Paragraph 12.10.D and all subsidy layering requirements are met.

12.1.12**Pre-Construction Conference**

The pre-construction conference may be held concurrently with the initial closing, since the required parties attend the closing, and the pre-construction conference must be held before the start of construction. Instructions for conducting the pre-construction conference are in Chapter 13.

12.1.13**Initial Draw of Loan Proceeds**

Initial draw of loan proceeds may be made on the day of closing upon recordation of the mortgage instruments and evidence that they constitute a first lien on the entire property. See Chapter 13 for information regarding an initial draw at initial closing.

12.1.14**Loan Closings for Residential Care Facilities**

- A. The requirements of paragraph 12.1.4 through 12.1.8 must be met except for the following below:
- B. Mortgage (Deed of Trust) Note.
1. Must be on HUD/FHA form approved by HUD for use where the project is located.
 2. Maximum term may not exceed 40 years from the beginning of amortization for new construction and 35 years for a refinancing pursuant to Section 223(f).
 3. Must identify on the panel of the note the section of the NHA Act (Section 232 or Section 232 pursuant to Section 223(f) of the National Housing Act) and the regulations under which the mortgage is insured.
 4. Shall contain the following prepayment provisions:
 - a. Proprietary Facilities
 - (1) Prepayment must be permitted in whole or in part so long as 30 days advance written notice is given to the mortgagee of intent to prepay.
 - (2) Prepayments must be permitted for up to 15 percent of the original principal amount in any one calendar year without a prepayment charge. Prepayments exceeding 15 percent may be subject to a charge agreed to by the mortgagor and mortgagee and included in the mortgage, except as set out in Paragraph 12.1.4.H.2.e, above.
 - b. Nonprofit and Public Facilities.
 - (1) Upon prior consent of the Commissioner, the mortgage debt may be prepaid in full.
 - (2) The Commissioner may approve partial payments to reduce succeeding monthly payments over the remaining portion of the original mortgage term.
 - (3) The Commissioner may also approve partial prepayments made after 30 days written notice. Prepayments exceeding 15 percent of the original principal amount may be subject to a reasonable charge on such excess agreed to by the mortgagor and mortgagee and included in the mortgage, except as set out in Paragraph 12.1.4.H.2.e, above.
- C. Regulatory Agreement for Health Care Facilities (Form HUD-92466 for for-profits; Form 92466E for non-profits). Must be incorporated by reference into the mortgage. The mortgagor may be regulated or restricted (with prior Headquarters' approval) on other matters as long as they do not conflict with program requirements. Where a project is leased to a residential care facility operator, the lessee, and all future lessees, must also execute a Regulatory Agreement (Form HUD-92466-NHL).
- D. Any reduction in the original principal amount of the mortgage resulting from the certification of cost from which HUD may require shall not be construed as a prepayment of the mortgage.
- E. Delayed Repairs Escrow-Existing Projects pursuant to Section 223(f). Where repairs will be delayed until after endorsement, the cost of such repairs must be withheld in cash from mortgage proceeds. These funds, plus an additional amount in cash or letter of credit of at

least 50 percent of the repair estimate, must be placed in escrow. Only the amount above the 100 percent cash requirement may be provided by a letter of credit.

12.1.15**Changes in Construction and/or Permanent Loan Interest Rates**

- A. If the construction interest rate is reduced before initial endorsement and it is not feasible to reprocess the project, the firm commitment must be amended to contain the following condition:
- “Any interest savings resulting purely from a differential between the HUD processed interest rate and the actual construction 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 saving must be applied as a mortgage reduction.”
- B. If the construction interest rate is increased before initial endorsement, the firm commitment must be rescinded and the application reprocessed to reflect the higher rate.
- C. The firm commitment must be reprocessed if the evidence submitted does not indicate that the permanent financing will be available at the rate, for the term, and for at least the mortgage amount identified in HUD’s commitment.
- D. A willingness of the permanent lender to reduce the interest rate after initial endorsement does not constitute a basis for a mortgage increase.

12.1.16**Submission of Recorded Documents**

The mortgagee is responsible for submitting to HUD, within 15 days of the receipt from the applicable recording office, three copies of the recorded and filed document as well as the original Regulatory Agreement.

12.1.17**Retention of Closing Documents**

- A. The HUD field office should retain the original review sheets as well as the original, duplicate original or executed copy of each closing document for the Washington Docket, except that a completely legible copy (certified true and correct) should be collected where the original is unavailable because of filing or recording requirements (certified true and correct by the recorder). Conformed copies of each closing document should be retained for the Hub Docket, using duplicate originals or executed copies where available. (The Hub Director shall prepare the information in the Closing Memorandum, Form FHA-290.)

The Phase I Environmental Clearance is a “program requirement” as well as a “supporting document” for the environmental assessment (HUD 4128). It should remain with the HUD 4128 in the Washington Docket as a part of the permanent, historical file.

B. Multifamily Insurance System (MFIS).

1. The Official Receipt, Form HUD-27038, and Schedule of Project Collections, Form HUD-3416, will be completed, and
2. Mailed within 5 days of a project's initial closing along with one copy each of the Closing Memorandum, Form FHA-290; Official Receipt, Form HUD-27038; and Schedule of Project Collections, Form HUD-3416; to:

U.S. Dept. of HUD
Multifamily Insurance Operations Branch
P. O. Box 44124
Washington, D. C. 20026-4124

12.2 Final Closing-Insurance of Advances

12.2.1

General

- A. Introduction. Once construction has been completed in accordance with paragraph 12.2.1.C, below, and certification of costs has been presented to and approved by HUD, the mortgagor must proceed to the final closing of the mortgage insurance transaction. (If possible, it is advisable to hold final closing until after the period for filing mechanics liens under state law has expired.)
- B. Title Evidence at Final Endorsement. Prior to final endorsement, the mortgagee must provide HUD with a new title policy, or, if approved by the HUD closing attorney, a title endorsement covering the following matters:
 1. Showing what, if any, matters have gone of record since initial closing;
 2. Bringing the effective date forward to the day of final closing;
 3. If a Modification Agreement or Supplemental Mortgage and Consolidation Agreement are used, insuring that the mortgage, as modified, or as supplemented and consolidated, still is in first lien position. Should the title insurance company be unable to provide such endorsement, or should the endorsement show any lien intervening between the recordation of the original insured mortgage and the supplemental mortgage, HUD will not endorse the mortgage for insurance at the increased amount.
 4. Any exception to title, not shown in the title evidence accepted at initial closing should be examined carefully by the field office to determine whether or not it affects the value and/or marketability of the project. Any exception which affects the value and/or marketability of the project as determined by the Hub Director shall be removed from the title policy or its effect insured against by an appropriate endorsement to the title policy.
 5. Deleting the pending disbursements clause.

6. Increase of title coverage, if mortgage amount has increased.
- C. Completion, for the purpose of final closing, means that:
1. The project has been completed in accordance with the drawings and specifications as indicated by the date of the final trip report, except for approved items of delayed completion covered by an acceptable escrow agreement (See paragraph 12.2.3.B); and
 2. The entire project has been accepted for occupancy by the local authorities having jurisdiction, by the lender, and by HUD.
- D. Preparation for Final Closing.
1. Upon the determination by HUD that an advance of mortgage funds is, or will be, the last advance prior to disbursement of the contract retainage (or at the time of substantial completion, whichever is earlier) preparation for final closing and final endorsement of the mortgage instrument should begin.
 2. The Hub Director should advise the HUD closing attorney with respect to these determinations and should also advise the mortgagor in writing (with a copy to the HUD closing attorney) of the time estimated to be necessary to complete the work necessary to hold the final closing. The requirements for final closing are set out in the HUD Closing List, Appendix 1 and the HUD Form 2580, Maximum Insurable Mortgage. (These requirements may be modified to comply with local law requirements.)
- E. Date for Final Closing. Upon completion of the review of the certification of actual cost, upon preparation of FHA Form 2580 and upon receipt of the agreement described at Paragraph 12.2.4.C, if such agreement is required, the Hub Director will advise the mortgagee and HUD closing attorney of his findings and readiness for final closing and a date acceptable to all parties for the closing shall be set.
- F. The Hub Director must assure that Labor Relations Staff have approved proceeding to final endorsement, and that, if required, deposits to the U.S. Treasury have been established as a condition of closing to ensure payment of wages.
- G. Final closings may be conducted by escrow or by mail, at the request of the mortgagee, unless the HUD closing attorney reasonably determines such closing to be inappropriate due to the circumstances of the particular case.

12.2.2**Property Insurance Requirements**

- A. Ascertainment of Changes. After the submission of the cost certification audit and before the mortgagor proceeds to final closing, the Hub Director will ascertain whether any changes in drawings and specifications, or any appreciable change in the cost of construction of the

project, have occurred during the course of construction which require a revision of Property Insurance Schedule, HUD Form 92329.

- B. **Action on Revised Form.** If it is not necessary to revise the previous HUD Form 92329, no action on the part of the Hub Director is required with respect to property insurance. If a revision of HUD Form 92329 is necessary, the Hub Director will obtain revised and corrected copies of the Form, relating such changes, and, at the time of execution of FHA Form 2403, will forward duplicate revised copies to the mortgagee with an appropriate letter notifying the mortgagee to substitute the revised copies (identifying such revised form by date) for the previous HUD Form 92329. In all cases of revision of HUD form 92329, or correspondence in connection therewith, copies of the revised Form and correspondence will be filed in the Washington and duplicate dockets.

12.2.3

Incomplete On-Site and Off-Site Facilities

- A. **Conditions for Approval.** It is desirable that all on-site construction be 100% complete before approval of a final advance of mortgage proceeds. There may however, be circumstances where it is desirable that approval of a final advance be given before 100% completion of on-site construction.
1. Approval of a final advance where minor items of on-site construction are incomplete will be given only in cases in which funds are placed in escrow to assure completion of such minor items, as provided in the certificate of mortgage insurance on FHA Form 2403, and in footnote on Request for Final Endorsement of Credit Instrument, HUD Form 92023. (For procedures in connection with HUD Form 92023, see Paragraph 12.2.6.A).
 2. Approval of a final advance of mortgage proceeds will be given only in those cases in which:
 - a. All on-site items in the entire project are completed, except those which qualify as items of delayed completion, as described in paragraph 2.c, herein;
 - b. All off-site utilities such as sewer, water, electrical, and gas facilities are installed and connected, and the buildings are served by safe and adequate all-weather facilities (either permanent or temporary) for the ingress and egress of pedestrian and vehicular traffic, including fire apparatus, and all other construction requirements have been acceptably accomplished or acceptably assured;
 - c. The Hub Director recommends that funds be placed in escrow for the completion of minor items because immediate completion is inadvisable or impossible, due to weather or other conditions beyond control; and
 - d. The aggregate estimated cost of completing the above items does not exceed 2% of the principal amount of the mortgage.
- B. **Escrow for Completion.** With respect to all incomplete items, the amount held in escrow for completion must be at least one and one-half (1 1/2) times the estimated cost of completion. The amount of any escrow shall be sufficient to assure an incentive to complete the work,

taking into consideration a possible rise in cost. Such escrow will be held by the mortgagee in accordance with the terms of the Escrow Deposit Agreement, FHA Form 2456, and the Hub Director will ascertain that the items to be completed are properly identified by attachment to FHA Form 2403. (See Paragraph 12.2.5.F.)

- C. Escrow for Painting. In many instances the desirability of selection of color schemes by the incoming tenant is recognized. In order to enhance rentability, and if acceptable to the Hub Director, an escrow may be established to cover the cost of final interior painting of apartments without regard to the usual 2% of the principal mortgage amount limitations on escrows previously mentioned. This is conditioned upon the builder being bound to complete all work covered by the approved plans and specifications within a fixed period of time (not in excess of one year from the date of final endorsement for mortgage insurance) and without any additional charge either to the mortgagor or to the incoming tenants.
- D. Distinction Between Forms of Assurance. When a request for approval of a final advance is received in a case in which off-site facilities are incomplete, a distinction must be made between those cases in which the assurance of installation and completion is in the form of a cash escrow, and those cases in which such assurance is in other form. In approving or disapproving the final advance, the Hub Director will be guided by the following instructions.
 - 1. CASH ESCROW. When the completion and installation of off-site facilities is assured by a cash escrow, and all off-site sewer, water, electrical, and gas facilities are completely installed and connected, and other off-site facilities such as streets, walks, curbs, and gutters are incomplete but safe, and adequate facilities for ingress and egress are provided, approval of the final advance of mortgage proceeds may be given. The Hub Director will however require that the escrow agreement remain in force and will diligently pursue the completion of off-site facilities as assured by the escrow.
 - 2. OTHER FORMS OF ASSURANCE. In those cases in which the assurance of installation and completion of off-site facilities is in a form other than a cash escrow, the final advance of mortgage proceeds cannot be approved. Instead, the Hub Director will invoke the provisions of the building loan agreement and construction contract wherein it is provided that the 10% holdback will be retained until 100% completion of off-site facilities.
- E. Completion of Off-Site Utilities. Until all off-site facilities are completely installed and connected, as applicable, and the required ingress and egress is provided, HUD will not process a request for the final advance. In such cases:
 - 1. Any FHA Form 92403 submitted for processing will not be treated as approval of a final advance, nor will the submission of Request for Final Endorsement of Credit Instrument, HUD Form 92023, be in order. Instead, the FHA Form 2403 may be treated as an ordinary application for advance of mortgage proceeds and may be approved in an amount which, when added to previous advances of mortgage proceeds, will equal 90% of the total advances to which the mortgagor will be entitled at 100% completion.
 - 2. Following 100% completion of all off-site facilities, the Hub Director will require submission of a new FHA Form 92403 for approval of the final advance, and subsequent submission of HUD Form 92023.

3. The Hub Director will endeavor to obtain completion at the earliest possible time.

12.2.4

Chattel Mortgage and First Payment to Principal

- A. **Non-Realty Items.** All non-realty items must be covered by the mortgage lien or security agreement, or both, whether or not paid for with mortgage proceeds, so long as such items are required in the operation of the project. These include, but are not limited to ranges, refrigerators, washers, dryers, water heaters, dishwashers, venetian blinds, removable air conditioning units, lobby furniture and similar items necessary for the operation of the project. Any items not secured at initial closing must be secured at final closing, See Paragraph 12.1.4.G.2.
- B. **Establishing First Payment to Principal**
 1. **Start of Amortization.** Whether construction has been completed or not, amortization must start on the date specified in the mortgage, unless a deferment has been recommended by the mortgagee and approved in advance by HUD.
 2. **Advance Amortization Requirements.** In order for the Hub Director to determine whether or not advance amortization is required, the mortgagor must account for all operating income for the period ending three months prior to the originally scheduled date of the first principal payment under the mortgage (e.g., through June 30 if first principal payment is scheduled for October 1).
 3. **Income and Expense Statement Requirement.** In connection with cost certification, the mortgagor will already have reported the results of occupancy during the cost certification period. Therefore, when more than three months intervene between the cost certification period and the first principal payment as originally scheduled, the Hub Director will require an income and expense statement covering the period beginning at the end of the cost certification period and ending three months prior to the date of the first principal payment under the mortgage as originally scheduled.
- C. **Agreement of Mortgagor.** When final closing is scheduled after the close of the accountability period, the income and expense statement should, of course, be submitted prior to final closing. When final closing is scheduled before the expiration of the accountability period, the mortgagor must agree in writing, as an inducement to the Commissioner to approve the final disbursement of mortgage proceeds prior to the expiration of the accountability period:
 1. To furnish an income and expense statement for the required period within 30 days after its expiration, and
 2. To immediately apply, as a mandatory prepayment to the mortgage, such portion of the net operating income as the Commissioner may require.
- D. **Treatment of Items in Statement.** In the preparation of the income and expense statement, the mortgagor must include as income all rents received, exclusive of security deposits. All expenses for operation, including taxes, insurance, HUD-FHA MIP, interest and reasonable

management fees (but not officers' salaries or depreciation), may be deducted in determining net income for this purpose. If the cost certification reveals an excess of expense over income, such excess (to the extent recognized by the Commissioner) may be carried forward to the statement required by this paragraph as "unrecovered expense prior period."

- E. Required Prepayment. The amount of, and the handling of, the prepayment required is subject to the following:
1. In no case shall the required prepayment exceed the amount which would have been due in cumulative principal payments if the first scheduled payment had been on the first of the month in which the accounting period started.
 2. Prepayment will be required only to the extent that the amount of the net income permits payment of one or more full monthly principal payments as scheduled.
 3. If the circumstances are such that the operating statement is submitted before final endorsement, the mortgagee and mortgagor may elect to have the mortgage endorsed for less than the face amount by a sum equal to that which would have been required as mandatory prepayment.

12.2.5

Mortgage Amount

- A. Determination of Maximum Mortgage. On completion of the review of certificates of actual cost and acceptance thereof, Form FHA-92580, Maximum Insurable Mortgage, shall be executed by the Hub Director for the purpose of indicating to the mortgagee and mortgagor whether or not a reduction in the original amount of the mortgage is necessary.
1. Upon execution of FHA Form 92580, the original shall be forwarded to the mortgagee and an executed copy shall be forwarded to the mortgagor.
 2. One copy shall be placed in the field office docket and one copy in the Washington docket with copies of the cost certification exhibits.
- B. Decrease in Mortgage Amount:
1. If HUD's review of the cost certification results in a decrease in the mortgage amount, which decrease would be set forth in Form HUD-92580, *Maximum Insurable Mortgage*, the Mortgagee must, subject to local practice, prepare and submit to HUD, prior to final endorsement, a proposed Modification Agreement, in a form acceptable to HUD, modifying the mortgage amount and the payment amount accordingly. The final endorsement for insurance shall be in the lesser mortgage amount. There is no prescribed form of modification agreement, although there is one mandatory provision, as follows:

Nothing in this Agreement shall waive, compromise, impair or prejudice any right HUD may have to seek judicial recourse of any breach of that certain Regulatory Agreement executed by the parties hereto, recorded on even date with the Mortgage, which breach may have occurred prior to or may occur subsequent to the date of this Agreement. In the event that HUD initiates an action for breach of said Regulatory Agreement and recovers

funds, either on HUD's own behalf or on behalf of the Project or the Mortgagor, those funds may be applied, at the discretion of HUD, to payment of the delinquent amounts due under the Note or the Mortgage or as a partial prepayment of the Note.

2. In addition, an allonge to the mortgage note, to be approved by HUD, may also be necessary under state law to modify the mortgage amount and set forth the new amortization schedule. The allonge is to be attached to the original note. Prior to final endorsement, the modification agreement must be properly executed and recorded in the real property records of the county in which the project is located.
 3. If a small mortgage decrease is involved, and the mortgagor does not request a change of amortization, a notation on the insured Note indicating that the mortgage loan amount is reduced without a change in amortization, may be used. In this case, the finally endorsed amount will reflect the reduced principal balance.
- C. Increase in Mortgage Amount: If the Hub Director approves an increase in the mortgage amount, the following documents must be included in the package of draft closing documents submitted to HUD for final endorsement:
1. Increase Note. The Mortgagee must prepare a Note using the form required in Paragraph 12.1.4.G herein, but entitled "Supplemental Note," and containing a cross-default provision with the original note. The principal amount of the Supplemental Note shall be for the amount of the increase to the mortgage, not for the new total mortgage amount. The amount of the payments to principal shall be sufficient to amortize the increase amount over the mortgage term.
 2. Increase Mortgage. The Mortgagee must prepare a mortgage or deed of trust using the form required in Paragraph 12.1.4.G herein, but entitled "Supplemental Mortgage," and containing a cross-default provision with the original mortgage. The Supplemental Mortgage shall encumber the project and shall secure repayment of the Supplemental Note.
 3. Modification and Consolidation Agreement. The Mortgagee must prepare a Modification and Consolidation Agreement, using a format approved by HUD, to evidence that the original note and the supplemental note represent and shall be deemed one indebtedness, to evidence that the original mortgage and the supplemental mortgage represent and shall be deemed one security instrument, and modifying the original mortgage to provide for cross-default with the supplemental mortgage. Prior to final endorsement, the Supplemental Mortgage and the Modification and Consolidation Agreement must be recorded in the county real property records where the project is located.
 4. Mortgagor's Attorney's Opinion. The Mortgagor's attorney must give an opinion, in a format approved by HUD, with respect to the documents evidencing the increased mortgage amount.
- D. Excess Mortgage Proceeds. There is a remote possibility that the cash paid out for completion of a project may be less than the mortgage proceeds. In such circumstances, the Hub Director shall require that any part of the mortgage proceeds which have not been expended to pay necessary costs of completing the project shall be deposited in a special account of the mortgagor, from which disbursements may be made only with the prior written consent of the Hub Director. This requirement is stated in paragraph (4) of the Agreement and Certification, FHA Form 3305.

There will be no obligation for the investment of such funds in obligations of, or fully guaranteed as to principal by, the United States of America, or for their deposit in institutions whose accounts are insured by the United States. The establishment of the fund can be avoided by an immediate reduction of the mortgage at closing, before establishment of the amortization schedule.

1. The Hub Director will approve or disapprove the use of the funds for purposes other than reduction of the mortgage.
2. If the mortgage proceeds exceed the cash paid out for completion solely because there is a difference between the purchase price of land for a period of years and its "fair market value" in fee simple and as is: as determined by HUD, the Hub Director may waive this requirement.
3. The request for waiver should be accompanied by full information as to the date of purchase and purchase price of the land and normally will be approved in situations such as the case of an individual mortgagor who obviously cannot "buy" the land from himself, as contrasted with a corporate mortgagor, which could buy land from its sole or majority stockholder.

E. Mortgagor's Investment

1. The amount of the mortgagor's initial equity investment is to be determined as follows:
 - a. New Construction and Substantial Rehabilitation (Except 232 Substantial Rehabilitation): Equity is determined by taking line 6, FHA Form 2580 and subtracting from that amount the finally endorsed mortgage amount.
 - b. Section 232 Substantial Rehabilitation-Property Owned: Equity is determined by taking line 4, FHA Form 2580 plus the HUD-FHA estimate of "as is" value of the existing land and improvements before rehabilitation and subtracting from that amount the finally endorsed mortgage amount.
 - c. Section 232 Substantial Rehabilitation-Property Acquired: Equity is determined by taking Line 4, FHA Form 2580 plus the lesser of (1) FHA as is value of the existing land and improvements before rehabilitation or (2) acquisition cost of property and subtracting from that amount the finally endorsed mortgage amount.
2. To the base amount as determined by (a), (b), or (c) above, whichever is applicable, there may be added certain cash outlays for furnishings, equipment, or other betterments essential to the operation of the project. The nature and extent of such outlays shall be substantiated by a supporting schedule in a manner satisfactory to the Hub Director. The schedule shall set forth the vendor's name, a description of the item or items purchased, the total price, and the cash paid on account of the price. The schedule shall be signed by an authorized representative of the mortgagor.

Once the aforesaid determination has been made, the Hub Director will immediately notify the mortgagor in writing as to the amount of the initial equity investments. A copy of such determination shall be attached to each copy of the FHA Form 2580.

F. Application for Insurance of Advance of Mortgage Proceeds. FHA Form 2403 is the form used during the course of construction for the advance of mortgage proceeds. When the final

advance is in order, the mortgagee and the mortgagor will execute the completed form, and the form will be submitted by the mortgagee in triplicate. The form shall be accompanied by: (1) a completed Contractor's Requisition, FHA Form 92448, signed by the contractor and the architect; and (2) a final as-built survey.

1. The survey accompanying this request must show the exact location of all buildings, water, sewer, gas and electric mains, and all easements for such existing utilities. It must be prepared by a licensed surveyor who must include a certification in the format set out in HUD Form 92457, Surveyor's Report.
2. If no items of on-site construction are incomplete, type into the Certificate of Mortgage Insurance on FHA Form 2403, in the space provided for the amount of the escrow deposit, the word "None". If items of on-site construction are incomplete and an escrow deposit (in accordance with paragraph 12.2.3B) is in order, attach to FHA Form 2403 an itemized list of incomplete items; and type into the Certificate of Mortgage Insurance, in the space provided, the amount of the escrow deposit required for completion of incomplete items.
3. On ascertaining that the advance will be the final advance of mortgage proceeds, the Hub Director will determine whether:
 - a. Any items of on-site construction are incomplete;
 - b. Any off-site facilities are incomplete;
 - c. Any revisions are required in connection with hazard insurance; and
 - d. The necessary chattel mortgage has been submitted;

The Hub Director will be guided accordingly.

4. Following execution of FHA Form 2403, the Hub Director will forward the executed original to the mortgagee, with necessary attachments listing incomplete items, if any. If the FHA Form 2403 is for final advance of mortgage proceeds, at the time the Field Office Director returns the Form to the mortgagee, the mortgagee's attention must be called to the proviso in the "Certificate" section of the Form concerning the fact that this last advance shall not be considered insured until the occurrence of the events set forth in such proviso. An executed copy will be filed in the Washington docket, and one copy will be forwarded to the Hub Director.
4. In accordance with the Certificate of Mortgage Insurance, it is then the responsibility of the mortgagee to submit a completed Request for Final Endorsement of Credit Instrument, Form 92023, with the credit instrument and any necessary escrow agreement. It is desirable, however, that the Hub Director in forwarding the completed Form to the mortgagee, call to the mortgagee's attention such additional submissions as are required, and at the same time forward to the mortgagee copies of HUD Form 92023 and, if necessary, Escrow Deposit Agreement, FHA Form 2456.

12.2.6

Final Endorsement

- A. Request for Final Endorsement of Credit Instrument, HUD Form 92023. After receipt by the mortgagee of approval of a final advance, HUD Form 92023 completed and executed by the mortgagor, mortgagee, and general contractor, must be submitted in duplicate, with the original credit instrument and, if required, three conformed copies of Escrow Deposit Agreement, FHA Form 2456.
1. On receipt, HUD Form 92023 will be checked against each previously approved FHA Form 2403 to determine that the amount of each advance is correctly stated and that the total shown on the HUD Form 92023 equals the total of all advances. If any error is found, the form will be returned to the mortgagee with an explanation of the correction required. The inclusion of an amount advanced by the mortgagee to the mortgagor from escrow funds required for completion of the project is a common source of error, and it is important that such amounts be excluded from HUD Form 92023. When reviewing this form, the Hub Director should examine the title evidence submitted prior to final closing to confirm the certification by the mortgagor as to items of outstanding indebtedness.
 2. Particular attention is directed to the required certifications by the mortgagor and the general contractor with respect to their obligations and the penalty provided by law for misstatements. HUD Form 92023, as revised, requires in every case a full disclosure by both the mortgagor and the general contractor of all outstanding unpaid obligations. Sufficient funds from the final advance of mortgage proceeds should be placed in escrow with the mortgagee or with an escrow agent for disbursement to satisfy all unpaid obligations disclosed on HUD Form 92023 and attachments. Such funds are to be released from escrow only upon the mortgagee or escrow agent being furnished with simultaneous acknowledgment of payment by the general contractor and/or appropriate subcontractor or materialmen. However, in all cases the Hub Director shall proceed as follows:
 - a. Mortgagors shall be advised that all unpaid obligations contracted in connection with the acquisition of land, purchase of property, construction of the project, or the mortgage transaction shall without exception be reported on HUD Form 92023 as required by the Certificate of the Mortgagor. Likewise, General Contractors shall be advised that all unpaid obligations contracted in connection with the construction contract shall be reported on HUD Form 92023 as required by the Certificate of the General Contractor.
 - b. The unpaid obligations of the mortgagor listed under b and c of paragraph 2 of the Certificate of the Mortgagor on HUD Form 92023 shall not exceed the amount of the final advance of mortgage proceeds. In the event that a HUD Form is received showing such an excess, it shall be returned to the mortgagor with the advice that the differences must be liquidated by cash payment or through the issuance of stock or a promissory note. A corrected HUD Form 92023 must then be submitted. If a promissory note is used, it must be on the proper HUD prescribed note form and no change in substance shall be permitted. Two copies of all notes should be obtained for filing in the Field Office and Washington dockets.
 - c. In any case where the amount of the unpaid obligations certified by the general contractor exceeds the amount certified as due the general contractor by the mortgagor, the Hub Director shall urge the prompt payment of such excess obligation. If there is an identity of interest between the mortgagor and the general contractor the Hub Director shall immediately notify the mortgagor that final endorsement will be

withheld until evidence is furnished that sufficient cash is available to pay all outstanding obligations in full.

- d. When these forms are satisfactorily completed and submitted, it is in order to proceed with the final closing. The date of final endorsement will be the date the Field Office Director or his authorized agent affixes his signature to the credit instrument. The original of HUD Form 92023 will be filed in the Washington docket, the copy of FHA Form 2456 will also be filed in the Washington docket, and a conformed copy filed in the Field Office docket.
 - e. Paragraph 3 of the Certificates of the Mortgagor and the General Contractor on HUD Form 92023 requires the submission of receipts for the payment of the reported unpaid obligations within prescribed time limits.
 - (1) If the receipts for reported unpaid obligations are not received by the deadline, it is the responsibility of the Hub Director to immediately make appropriate inquiry in writing.
 - (2) If the receipts for the payment of the reported unpaid obligations are not received within two weeks from the date of such inquiry, the Hub Director will take appropriate action.
- B. Amount of Endorsement. The credit instrument will be finally endorsed in an amount equal to the full amount of all insured advances to the mortgagor, as shown by the applicable HUD Form 92023, regardless of whether the final endorsement occurs before or after the commencement of amortization of the insured mortgage.
- C. Working Capital Deposit. One year after the construction contract completion date, the mortgagee shall be entitled to release any balance of the working capital deposit to the mortgagor (but only to the mortgagor.) The Hub Director is not required to approve or disapprove such action; but, if consulted, shall point out to the mortgagor and mortgagee that both should give careful consideration to the position of the mortgagor (percentage of occupancy, etc.) and should point out, also that any release of such funds while a mortgage default exists will be the sole responsibility of the mortgagee. The mortgagee must also consider the provisions of Paragraph 6(a) of the Mortgagee's Certificate.
- D. Title Policy. The final title policy must be dated the same date as the date of the final endorsement of the Note.

12.2.7

Guarantee Following Completion

- A. Assurance of Performance under Guarantee. The Construction Contract, Form HUD-92442 or FHA 2442A, contains a guarantee against any defects due to faulty materials or workmanship, which appear within a period of one year following completion. The date of completion is defined in paragraph 12.2.1.C, above.

B. Cash Assurance. Upon final endorsement, if a Completion Assurance Agreement, Form HUD 92450, was used at initial closing, the remaining escrow funds may be released except for the following:

1. An amount equal to the sum paid the general contractor pursuant to a Construction - Contract - Cost Plus less the actual cost of construction as determined in the cost certification which amount shall be refunded to the mortgagor; and
2. An amount equal to 2 1/2 percent of the total amount of the construction contract retained in an escrow for a period of fifteen months from the date of completion.

The 2 1/2 percent escrow shall be held to guarantee against defects in the construction due to faulty materials or workmanship or damage to the mortgaged premises resulting from such defects that become apparent within one year after the date of completion. The contractor's liability for such corrections is not limited by the amount of the escrow. In addition, the funds are to be kept separate from any escrow that may have been provided to assure completion of any incomplete construction items.

C. Other Assurance. If Form FHA 2452, Performance Bond-Dual Obligee, or the American Institute of Architect's Form AIA A311, Performance Bond, were used, no action is required as both instruments remain in effect for two (2) years from the date on which final payment under the construction contract becomes due. As part of this assurance, the surety will be required to perform when the general contractor fails to refund any overpayment to the Owner, a requirement of Article 3, Construction Contract-Cost Plus, Form FHA 2442A.

12.2.8

Distribution of Closing Instruments

A. Chronology of Mortgage Transaction. At final closing, the Hub Director will be responsible for the preparation of two copies of Form FHA 260, Chronology of Mortgage Transactions, and the Closing Memorandum, Form FHA 290, and to promptly send these forms to the Office of the Comptroller in Headquarters. In addition, a copy of the chronology will be filed in both the Field Office Docket and the Washington Docket.

B. Preparation of Washington Docket. Immediately upon final endorsement of the credit instrument (regardless of whether there are any funds in escrow) the Hub Director will require preparation of a permanent Washington Docket. The forms and documents to be filed in it and instructions for its preparation are given in FHA Form 2471, Contents of Washington Docket.

1. As the availability of the Washington Docket is necessary for the adjustment of the mortgage insurance premium account and for routine preparation of the amortization schedule by the Multifamily Insurance Operations Branch, the following documents will be required:

- a. Insured Advances

- (1) Closing Memorandum (HUD Form 290)

- (2) Copy of Note
- (3) Copy of any Modifications
- (4) Schedules of Advances (HUD Form 92023)
- b. Insurance Upon Completion
 - (1) Closing Memorandum (HUD Form 290)
 - (2) Copy of Note
 - (3) Copy of any Modifications
2. If submission of the Washington Docket is delayed for any reason, separate requisition of amortization schedule must be made by the Field Office pursuant to instructions in Paragraph 12.2.9.A.
- C. Mailing of Washington Docket. Immediately following preparation of the Washington Docket, it will be forwarded to the Chief, Records Management HOAMP, Department of Housing and Urban Development, Room B264, 451 Seventh Street, S.W., Washington, DC 20410. The Comptroller will be responsible for recordation and safekeeping.
- D. Preparation of Field Office Docket. After preparation of the Washington Docket, all remaining original and duplicate material, except those covered in Paragraph 12.2.8.D, will be filed in the Field Office Docket. The contents of the Field Office Docket are to remain in chronological order.
 1. Correspondence may be fastened to the left side of binder.
 2. When a project is of such size as to make arrangement in one binder bulky, auxiliary binders will be made. The binder will be designated No. 1, No. 2, No. 3, etc., and the No. 1 binder will indicate the total number of binders.
 3. None of these binders or their contents may be destroyed before termination of mortgage insurance, nor shall recommendation be made to the National Archives for their destruction without prior approval of the Director, _____.
- E. Material Not In Washington or Field Office Dockets. The master set of drawings and specifications, and copies of all approved Construction Changes, FHA Form 2437, are not to be placed in either docket, but are to be handled as follows:
 1. Retain in the Field Office until expiration of the one-year guarantee period under the construction contract.
 2. After expiration of the one-year guarantee period review statements for completeness and so certify on FHA Form 2488.
 3. After review, integrate each set of plans, specifications and change orders in a tightly rolled bundle with the plans on the outside. Tie securely with twine at each end. Paste FHA Form 2488 securely on one end of the rolled bundle.

4. Forward to the regional Federal Records Center in accordance with Records Control Schedule, FHA 1, Item 5. This schedule provides for reasonable accumulations, on a once a year basis.
- F. Legal Docket. The HUD closing attorney may also require material for a docket to be kept by the legal office.

12.2.9**Requisition for Amortization Schedules**

- A. Preparation of Schedules. Timely preparation of amortization schedules is necessary for the convenience of mortgagees and to avoid misunderstandings on their part as to amortization requirements. Upon receipt of the Washington docket, the Comptroller may proceed with preparation and distribution of schedules to the mortgagee and field office.
1. If submission of the Washington docket is to be delayed, requisition for amortization schedule must be made by the Hub Director as follows: Immediately after final closing and insurance endorsement "Regulation for Multifamily Housing Mortgage or Loan Amortization Schedule", FHA Form 2409, will be prepared. When the required information has been entered on the Form and reviewed and the certification signed, it will be forwarded directly to the Multifamily Insurance Operations Branch, P.O. Box 44124, Washington, DC 20026-4124.
 2. FHA Form 2409 will be accompanied by copies of (1) the mortgage instruments (including any modifications thereof), (2) FHA Form 3307, Computation of Advance Amortization, (3) FHA Form-92580, Maximum Insurable Mortgage and (4) either FHA Form 2023, Request for Final Endorsement of Credit Instrument, or FHA Form 2455, Request for Endorsement of Credit Instrument - Certificate of Mortgagee and Mortgagor.
- B. Revision of Instruments. After final closing, revision of the terms or conditions of the insured mortgage will be governed by Paragraph 12.1.8.

12.3 Final Closing - Insurance Upon Completion**12.3.1****Preparation for Closing**

Completion, for the purpose of closing the mortgage transaction, means that the project has been completed in accordance with the drawings and specifications, except for approved items of delayed completion covered by an acceptable escrow agreement, and the entire project has been accepted for occupancy by local authorities having jurisdiction and by the mortgagee and HUD-FHA. The procedure and instructions are set out in Section 12.2 above.

12.3.2**Documents**

The documents required at closing are, for the most part, listed in Appendix 12A and are largely self-explanatory, except as discussed below.

- A. Mortgage Same as Paragraph 12.1.4.G, above
- B. Title Policy. Title evidence is to be continued to the date of endorsement of the credit instrument or recordation of the mortgage, whichever is later.
- C. Regulatory Agreement. Same as Paragraph 12.1.4.K, above.
- D. Assurance of Performance Under Guarantee. Before endorsement of the credit instrument, the mortgagor must furnish satisfactory evidence that the work of the a contractor is covered by a guarantee, running for a period of one year from the date of substantial completion, against defects due to faulty materials and/or workmanship. Performance will be assured by one of the following:
 - 1. Surety Bond: FHA Form 3259, Surety Bond Against Defects due to Defective Materials and/or Faulty Workmanship, by a surety on the accredited list of the U.S. Treasury and drawn in an amount not less than 10% of the cost of construction as estimated by HUD-FHA.
 - 2. Cash Escrow. A cash escrow equal to 2 1/2% of the principal amount of the mortgage, to be retained in escrow by the mortgagee for a period of one year.
- E. Collateral Agreements. See Chapter 8.
- F. Chattel Mortgage or Attorney's Certificate. Same as Paragraph 12.1.4.G.2, above.
- G. Mortgagor's Attorney's Opinion. Same as 12.1.6.I, above.
- H. Cost Certification. See Chapter 14.
- I. Advance Amortization Requirements. Same as Paragraph 12.2.4.B, above.
- J. Determination of Maximum Insurable Mortgage, FHA Form 2580. Same as Paragraph 12.2.5.A, above.
- K. Excess Mortgage Proceeds. Same as Paragraph 12.2.5.D except that the reference to FHA Form 3305 is to be read as FHA Form 3305A.
- L. Request For Endorsement of Credit Instrument. Certificate of Mortgagee and Mortgagor, FHA Form 2455. The procedure concerning outstanding obligations is the same as in Paragraph 12.2.6, above.
- M. Leaseholds. Same as Paragraph 12.1.4.E, above.

- N. Operating Deficit. If an operating deficit was projected on FHA Form 92264, the sponsors, at closing, must provide for funds to meet the deficit in the manner set forth in Chapter 7. The commitment requirements concerning funding shall not be waived, in whole or in part, unless specifically approved by the Hub Director. Amendments or modifications between the dates of start of construction and closing may not be waived without prior written approval of the Hub Director.
- O. The Hub Director must assure that Labor Relations Staff have approved proceeding to final endorsement, and that, if required, deposits to the U.S. Treasury have been established as a condition of closing to ensure payment of wages.

12.3.3

Incomplete Facilities

- A. Incomplete On-Site Facilities. Same as Paragraph 12.2.3, above.
- B. Incomplete Off-Site Facilities. All off-site sewer, water, electrical, and gas facilities must be completely installed and properly connected. Other off-site facilities such as streets, walks, curbs and gutters may be incomplete but safe, and adequate facilities for ingress and egress must be provided.
1. In all cases involving incomplete facilities, the certifications of completion will be accepted only if they are accompanied with assurances satisfactory to the Hub Director that the incomplete facilities will be completed within a reasonable time after endorsement of the credit instrument.
 2. The type of assurance with regard to completion of facilities shall be one of the following:
 - a. Public Authority or Utility: An assurance by a public authority or public utility company that such authority or company will complete the facilities without cost to the mortgagor.
 - b. Cash Escrow: A cash escrow held by or under the control of the mortgagee in an amount equal to at least the HUD estimate of the cost of completion. The escrow must provide that the funds cannot be released to the mortgagor except upon completion of all facilities to the satisfaction of HUD. It must further provide that the mortgagee has the right to expend the funds to the extent available for completion of such facilities, or to use such funds to reduce the principal amount of the insured mortgage by applying such funds to the last maturing installments of principal, upon receipt from HUD of notice to do so at such time as, in the opinion of the Hub Director, completion of the facilities is being unreasonably delayed.

12.3.4

Public Approvals

It having been determined before issuance of the commitment that the proposed project will not violate zoning laws or regulations, no further evidence will be needed unless, before final endorsement of the credit instrument, questions or litigation have arisen in connection therewith. If so, the Hub Director or closing attorney will require submission of such additional evidence as, in his opinion, may be necessary to substantiate the fact that no violations are involved.

12.3.5**Endorsement Of Credit Instrument**

The Hub Director may consult with other HUD staff, including the HUD closing attorney, prior to endorsing the credit instrument. The Hub Director, however, is fully authorized to initially endorse the credit instrument (Mortgage/Deed of Trust Note) after the First Year's Mortgage Insurance Premium and Inspection Fee have been received and concluding that all requirements for closing have been met. In no event shall the Hub Director endorse the credit instruments for an amount greater than the principal balance of the mortgage which would have been outstanding if all payments to principal due before the date of endorsement, (including required advance amortization payments if any) had been paid. Nor shall he endorse for insurance on a date after the first principal payment, until he has determined that all principal payments due have actually been made and the mortgage otherwise is current.

12.3.6**Revision Of Instruments Prior to Endorsement**

After commencement of construction, no commitment may be amended or reissued to permit any revision of terms or conditions of the mortgage which will result in any change in its principal amount (except as noted below), interest rate, or amortization provisions without the prior approval of the Hub Director. Any mortgage increase, if authorized, will be accomplished by an amended commitment.

12.3.7**Chronology of Mortgage Transactions, FHA Form 260**

Same as Paragraph 12.2.7.D, above.

12.3.8**Distribution of Closing Instruments**

Same as Paragraphs 12.2.8.A, above.

12.3.9**Requisition for Amortization Schedule**

Same as Paragraph 12.2.9, above.

Acquisition of an existing project or refinance of existing indebtedness may be achieved through HUD's Section 223(f) program and may involve limited repairs and improvements to the project.

12.4.1 Closing Requirements

The requirements of paragraphs 12.1.1 to 12.1.13 and 12.1.15 apply to section 223(f) closings except for such requirements as may apply exclusively to the insurance of construction advances.

12.4.2 Closing By Mail or Escrow

The mortgagee may submit the final, executed, closing documents (including the title policy) by mail or other delivery to the HUD closing attorney, to achieve closing without the need to be present in the HUD office if the HUD closing attorney determines such closing is appropriate under the circumstances of the particular case. The HUD attorney will review them to determine whether they are complete and in compliance with HUD requirements. If so, the HUD attorney will so notify the mortgagee and will obtain the endorsement of the promissory note by the appropriate HUD official. The mortgagee must make appropriate arrangements for handling of the original promissory note, both before and after endorsement.

12.4.3 Handling Of Administrative Requirements

HUD, and its closing attorney will take cognizance of any document(s) in proper form and content which are submitted during any stage of processing the HUD firm commitment and preparation for closing; such documents need not be resubmitted at closing.

12.4.4 Attendance At Closing

For the convenience of all parties, authorized agent(s) and signatories of HUD (housing officials) will be present or at all necessary times during the closing.

12.4.5 Closing Forms

There is no so-called "initial" closing/FHA endorsement because HUD does not insure advances from a construction loan. Instead, there is one closing at which FHA endorses only the "total sum" portion of the panel on the mortgage note. Many of the basic closing requirements for insurance of advances are the same or similar to those for insurance upon completion. Those that differ are discussed below.

- A. Mortgage note. The prepayment provisions for the section 223(f) program (excluding loans insured under Section 232 pursuant to Section 223(f)) differ slightly from those in the section 221(d)(4) program. Section 223(f)(3) of the national housing act, 12 U.S.C.A. § 1715nf3 provides for a five-year prepayment prohibition, except under certain, specified circumstances. Consequently, the following provision must be included in the note in addition to any other prepayment restriction permitted under Paragraph 12.1.4.H.2:

The indebtedness evidenced by this Note may not be prepaid in whole or in part, for a period of five years from the date of endorsement here of, except where the express written approval by HUD is obtained and written approval is expressly based upon the existence of one of the following:

1. The mortgagor has entered into an agreement with the commissioner to maintain the property as rental housing for the remainder of the specified five-year period;
 2. The commissioner has determined that the conversion of the property to cooperative or condominium ownership is sponsored by a bona fide tenants' organization representing a majority of the households in the project;
 3. The commissioner has determined that continuation of the property as rental housing is unnecessary to assure adequate rental housing opportunities for low- and moderate-income people in the community; or
 4. The commissioner has determined that continuation of the property as rental housing would have an undesirable and deleterious effect on the surrounding Neighborhood.
- B. Evidence of zoning compliance. (If a zoning endorsement to the title insurance policy is obtained, HUD may choose not to require additional evidence that the project complies with local zoning requirements.)
- C. Assurance of funds to meet operating deficits (if prescribed by the HUD firm commitment). For all facilities for which delayed completion of repairs will postpone or interrupt occupancy or income for any period, an additional deposit must be made to the operating deficit account.
- D. Occupancy Certificate. Not required as long as there has not been any new construction.

12.4.6

Additional Closing Documents

In addition to the items listed in Paragraph 12.4, the following documents are required for section 223(f) projects:

- A. Additional documentation of authority/amendment of organizational documents. The mortgagor's organizational documents must be amended, if necessary, to include the HUD required provisions. If the mortgagor's organizational documents require prior consent of or notice to the principals in the mortgagor entity for any proposed refinance, evidence of compliance therewith should be submitted.

- B. Request for final endorsement of credit instrument, Form FHA 2455. This form includes a certificate of mortgagee, certificate of mortgage and certificate of general contractor. It is used for insurance upon completion cases only. It should be completed so as to account for all of the funds required by the Firm Commitment.
- C. Short form cost certification (Form FHA-2205a). A modified form of cost certification for loans insured under Section 223(f) must be submitted 15 days prior to endorsement of the note. See Chapter 14, Cost certification, at paragraph 14.4.C.
- D. Certified closing statement. The mortgagee must provide a certified loan closing statement signed by the mortgagee and the mortgagor detailing the amount of any promissory notes made by mortgagor and any cash contribution made by the mortgagor and itemizing the disbursement of the mortgage proceeds and of the mortgagor's cash contribution, if any. The statement must list the amounts to be paid to satisfy the mortgagor's obligations for existing or other indebtedness, acquisition, repairs, discounts, financing fees, legal expenses, organizational expenses, title and recording costs, and like items, and any mortgagee-required escrows for taxes, insurance or other items.
- E. Escrow agreement for unpaid construction costs (Form HUD-92476.1). Generally, all work must be acceptable before the loan closing. Only noncritical repairs may be deferred until after endorsement. Noncritical repairs are those that will not endanger the safety and well-being of tenants, visitors and passersby, adversely affect ingress or egress, or prevent the project from reaching sustaining occupancy. The mortgagor must establish an escrow with the mortgagee for the estimated cost of repairs not completed at time of closing, plus an additional percentage, all as set forth in the firm commitment.
- F. Latent defect guarantee. Latent defects assurances are not required where the repairs relate only to deferred maintenance items and minor cosmetic repairs such as painting. When repairs and replacements are more significant, assurance against latent defects for one year from completion of repairs must be provided by one of the following:
 - 1. An escrow in cash, or letter of credit at the option of the mortgagee, equal to 2-1/2 percent (or greater percentage if required by the firm commitment) of the repair cost maintained for 15 months from completion of repairs to cover situations where the defect is discovered in the twelfth month and additional time is necessary to correct it; or
 - 2. A surety bond covered by Form FHA-3259 from a surety on the accredited list of the U. S. Treasury for at least 10 percent of the repair cost. (The bond runs for a period of two years from the date of completion of repairs.)
- G. Secondary financing. See Chapter 8.