



MULTIFAMILY ACCELERATED PROCESSING (MAP) Guide

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Office of the Assistant Secretary for Housing-
FHA Commissioner**

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The information collection requirements contained in this Multifamily Accelerated Processing Guide are a compilation of outstanding processing Handbooks (4425.2 Rev.2 Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Director for Project Mortgage Insurance; 4450.1 Rev. 1 Cost Estimation for Project Mortgage Insurance; 4460.1 Rev. 1 Architectural Analysis and Inspections for Project Mortgage Insurance; 4470.1 Rev. 2 Mortgage Credit Analysis for Project Mortgage Insurance; 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects); Approval of the Lender requirements in Chapter 2 is covered by **OMB Control Number 2502-0541**. The FHA and HUD Forms referenced in the Guide and set forth in the Forms Book which accompanies the Guide are approved as indicated on the Forms, particularly by **approval control numbers 2502-0001; 2502-0005; 2502-0010; 2502-0011; 2502-0018; 2502-0028; 2502-0029; 2502-0044; 2502-0057; 2502-0097; 2502-0112; 2502-0118; 2502-0305; 2502-0468; 2502-0470; and 2502-0416**.

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MAP Guide - Highlights

Section	Highlights
	<i>Chapter 1 – Introduction</i>
	Reference to New Project Concept Meetings stage.
	Added Underwriter Site Inspection and Rental Lease Audit Requirement
1.4C	Combine Pre-application and Firm Application Stage of Processing.
1.5D	Clarifies waiving of the MAP Guide Sections.
	<i>Chapter 2 - Lender Qualifications</i>
2.4	MAP Lender In-house Underwriter Approval Requirements
2.6	Identity of Interest between Map Lender and Tax Credit Syndicator.
2.10 - 2.15	Deleted/Moved to new Chapter 15.
	<i>Chapter 3 - Eligible Multifamily Mortgage Insurance Programs</i>
3.2.B	Single Asset Entity Requirements.
3.2F	Application fee modification
3.2.G.1	Charge \$30 per unit on projects without repairs. Applies to Section 207/223(f).
3.2.J	Correction of Fair Housing Act Violations under Section 223(f).
3.2 K	Previous Participation Electronic System (APPS).
3.2.P	Operating Deficit has new parameters when residents are displaced.
3.2.Q	Working Capital increased from 2 % to 4% of the mortgage.
3.2.R	Definition of affordable housing.
3.4.1	Substantial Rehabilitation and Acquisition/Refinancing -Abatement costs of Lead Based Paint and/or asbestos within an existing structure.
3.4.O	New parameters for NC/SR market studies with significant tenant displacement.

Section	Highlights
3.5.D.1	New parameters for maximum mortgage limitation for Section 221(d)(4) only.
3.5.D.4	New parameters on DSCR for Section 221(d)(4) only.
3.6.C	Change to DSCR for Section 221(d)(3) only.
3.6.C.4	Change to DSCR for Section 221(d)(3) only.
3.7.B	Section 220 projects with commercial space must be underwritten to market rate standards.
3.8	Treat a Section 223(f) application with both a purchase and a refinance transaction, as two separate transactions.
3.8.A	Former condominiums converting to rental apartments are eligible for Section 223(f).
3.8.K	New parameters maximum mortgage limitation for Section 223(f) purchase & refinance.
3.8.K.2 NOTE	Fifty percent of cash out from mortgage proceeds will be held in escrow until non-critical repairs are complete.
3.8.R	Section 223(f) occupancy standards underwriting guidance.
3.8.S	Section 223(f) consideration of obtaining a market study.

Chapter 4 - Application Requirements

4.1 B	Two stage processing or opting to combine both into the Firm.
4.3.C	Updated for partial electronic submission
4.2 A	Hub MAP Coordinator website.
4.2.A.1	Project concept meeting
4.2.A.2	Concentration on principal's risks that meet the threshold of \$250,000.
4.2.C	Pre-Application exhibit requires preliminary appraisal work & the Lender's creditworthiness assessment of the sponsor & \$250M HUD pre-approval
4.2.C.2.& 3 new	Pre-application exhibits must include preliminary appraisal work & lenders' assessment of sponsor's creditworthiness.
4.2.C.4 new	Two stage processing guidance.

Section	Highlights
4.2.D.3	Authorize three 30-day extensions.
 <i>Chapter 5 - Architectural Analysis</i> 	
5.1.A.1	Qualifications of Lender's Needs Assessor.
5.1.C	HUD approval of Lender's Needs Assessor.
5.2.A	Expanded to include new Architect's Professional Liability Insurance.
5.5.B.3	Acceptability of an existing survey market "re-surveyed."
5.7.C.3.d	Lender's authorized signatory is the only one who can sign the plans and specifications for the Lender. Lender must supply HUD with the name(s) of the authorized signatory.
5.24.B	Properties dating from the 1970s which contain hazardous aluminum wiring must undertake mitigation measures as a condition of Section 223(f) mortgage insurance.
5.24.C	Smoke detectors are required in Section 223(f) projects.
5.25.C	For a project with more than one structure, the Lender must prepare a Dwelling Unit Breakdown list and an estimate of the Gross Floor Area for each individual structure in the project.
5.26.A.2	Updating of PCNA when 120-day period expires.
5.26.D.2.b	
5.26.D.3.a	

Chapter 6 - Cost Processing

6.3.C.3.b.(1)	Section modified to eliminate Site Not Attributable.
6.3.C.3.d (3)	Ceiling for Rehabilitation Cost Not Attributable.
6.3.C.3.f	Eliminated the entire Section on Site Not Attributable
6.9.B.2	Independent Lender review of repair costs in PCNA is a required Firm stage deliverable.
6.9.2.A.1	PCNA prepared by Lender's Needs Assessor.

Section	Highlights
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6.10.1	Lender Project Processing – Firm Stage
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6.10.2	HUD Procedures
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Chapter 7 - Valuation Processing

7.4.A.1-8	Discusses and Clarifies Appraisal Requirements.
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7.4.A.9-13	Appraisal Requirements continued. Prohibition against confidential rent and sales comparables.
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7.6.F	Addition of the 220 program to vacancy and collection loss rate.
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7.6.G	Tenant improvements should be accounted for as a leasing expense.
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7.6.N	Apartments designed specifically for the elderly.
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7.7.F	Updating expense data method.
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7.8.I	A new section on site value for subsidized and/ or LIHTC applications.
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7.9.A.3, B.2	Identification of HUD as an authorized user for environmental assessments.
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7.10.B.5.f	Definition of Remaining Economic Life.
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7.11.A.6	Environmental Assessments are required for all 223(f) (including 202/223(f))
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7.11.B.4	Identification of HUD as an authorized user for environmental assessments.
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7.11.B.8.h	Lender’s appraiser must calculate Remaining Economic Life.
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7.16	Site Not Attributable to Dwelling use has been eliminated. This Section is renamed as “Tax Abatement/ Exception.”
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7.17	Renamed as “Section 8 and LIHTC Processing”
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Section	<i>Chapter 8 - Mortgage Credit Underwriting and Processing Requirements</i>
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8.2.A.3 & C.1	The electronic 2530 review and approval process begins at pre-application.
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8.3.A.5	Emphasize credit & financial analysis of key principals including fully funding
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Section	Highlights
	mortgagor entity.
8.3.B.5	Fannie Mae form will replace request for verification of deposit.
8.3.C.1	Identifying the Borrower and Its Principals expanded
8.3.D	Paragraph <i>Identifying The Principals</i> , revised to add LLC managing members and clarification.
8.3.1.d	Rejection Because of Unacceptable Credit, bankruptcy, insolvency, pending litigation with HUD.
8.3.F.2	Concentration on key principal's risks that meet the threshold of \$250,000.
8.3.H.2	Trade and Credit References expanded.
8.3.J	Expanded the experience analysis of a mortgagor and general contractors.
8.3.J.1.a	Same as 8.3.J
8.3.J.1.d	Expanded search for past roles in MF business.
8.3.J.2	Expanded the review of the resume for persons new to HUD MF business.
8.3.J.4 new	Added the need to demonstrate experience with owning/ operating LIHTC & Section 8 properties.
8.4.A.5	Emphasize credit & financial analysis of key principals including fully funding mortgagor entity.
8.4.B.2	The requirement for submission of three year balance sheet is expanded.
8.4.B.2.d	Added "Schedule of Real Estate Owned" & "Schedule of Mortgage Debt".
8.4.B.3.a	Increased requirements for Section 223(f) financial analysis.
8.4.B.3.d	Past due accounts payable and project liabilities must be cleared and released, or otherwise fully satisfied before closing.
8.4.C.1.c	Concentration on principal's risks that meet the threshold of \$250,000.
8.4.C.1.a(1) & (2)	Expanded the requirements of financial statement analysis.
8.4.C.2	Fully funded mortgagor entity is required to submit audited financial statements.
8.4.C.13	Add Historic Tax Credit transactions.
8.7.A.1.b	New parameters for the maximum mortgage limitation for Sections 221(d)(3) & (d)
December 2010	

Section	Highlights
	(4).
8.7.A.1.c.(4)	This paragraph was modified to remove Site Not Attributable (SNA) & replace with the warranted price of land.
8.7.A.1.c.(4)	New parameters for the per family unit limitations for Sections 221(d)(3) & (d)(4).
8.7.A.1.d	New parameters for the DSCR for Section 221(d)(3) & (d)(4).
8.7.A.2.b	New parameters for the maximum mortgage limitation for Section 221(d)(3) & (d)(4).
8.8.A.1.c	This paragraph was modified to remove Site Not Attributable (SNA) & replace with the warranted price of land.
8.8.A.1.b,d,& e	New parameters for the maximum mortgage limitation, DSCR & cost of acquisition.
8.8.A.2.b Note	Cash out from mortgage proceeds will be deferred until non-critical repairs are complete.
8.8.A.2.c	Fifty percent of cash out from mortgage proceeds will be held in escrow until non-critical repairs are complete.
8.8.D.6.a	Recent indebtedness defined.
8.9.B.1, B.2	New guidance for Secondary Financing from Government Sources and Private Sources.
8.10.B.3	New guidance on non-disclosure of grants and loans.
8.11	Subsidy layering review eliminated on Title II mortgage loans.
8.12.A	Introduction paragraph on evaluation on nonprofit mortgage/sponsor expanded.
8.12.A.9 new	Added the requirement for written explanation of non-performing assets.
8.12.B.5	Added a property manager and asset manager resume requirement when applicable.
8.12.B.6.b	Added no material, unmitigated contingent liabilities to the financial statement analysis.
8.12.B.7	Added must not have any unresolved internal control or compliance findings; unresolved issues of integrity or conflict of interest.
8.12.B.11 new	Added requirement to determine if the nonprofit has a proven record of raising sufficient funds to meet its operating needs.
8.12.C.1.e	Added must not have any unresolved internal control or compliance findings;
December 2010	

Section	Highlights
	unresolved issues of integrity or conflict of interest.
8.12.C.2.a	Added residential credit reports.
8.13	Insurance Upon Completion
8.14.E	The working capitol escrow percentage increased from 2 to 4 percent.
8.14.F	The operating deficit escrow is now based on the greater of the appraisal & underwriting analysis, 3 percent of mortgage amount or 4 months of debt service.
8.14 last para.	Cash out for land equity and other equity is deferred until final endorsement.
8.15.C.5	Excess premium income on Section 223(f) applications.

Chapter 9 – Environmental

There was a major rewrite for this entire Chapter

9.3	Expanded to include the requirements that the environmental professional firm conducting the Phase I must base is site analysis on the guidelines in the listed publications of the American Society of Testing materials (ASTM).
9.3	Discussion of remediation plans.
9.3	Discussion on Monitoring wells.
9.4	Details on field personnel responsibilities in reviewing cases requiring remediation; and remediation cost included in the mortgage.

Chapter 10 - Management Analysis

10.2.A.1	Added option to file electronic 2530 through – Active Partner Performance System (APPS) Participant Certification page.
10.2.A.7	Exhibit requirement added for marketing, leasing and relocation plan.
10.4	HUD Review of the Previous participation Certification (Form 2530) - Active Partners Performance System (APPS).

Chapter 11 - Lender Underwriting HUD Review

Section	Highlights
11.1.D.3	Development Application Processing (DAP) system made optional for processing, however is mandatory for tracking.
11.2B	HUD data verification and inspections.
11.2.D	USPAP Standard 3.
11.2.G	Basis for additional FO review.
11.2.G Note	Discusses extension of time for reviews.
11.2.H	Expanded the HUD review recommendation memorandum instructions
11.2.I.2 & 11.2 L.8	Added early start construction to the firm commitment decision Section & these requirements cannot be waived.
11.2.L.7	Paragraph modified to remove Site Not Attributable.

Chapter 12 - Construction Period

12.6.A.4	HUD Construction Contract takes precedence over inconsistent provisions in AIA Document A201, General Provisions, Article 9.8.
12.7.A.4	Construction contract retainage

Chapter 13 - Cost Certification

13.1	Eliminated need for cost certification on LIHTC projects where the ratio of the loan proceeds to the actual cost of the project is less than 80 percent
13.11.B.4.c	Non-disclosure of liabilities on balance sheets.
13.11.C.5	Added Form HUD-2205-A.
13.15.H.3.b.	Included the permanent Lender's fee up to 5-1/2 percent for bond-financed projects.
<u>NOTE</u>	

New Chapter Chapter 14 – Low Income Housing Tax Credit (LIHTC) Guidance

Chapter 15 - Quality Assurance Enforcement Actions

Section 15.2B	Removed the Program Center Director's recommendation to the MAP Lender
December 2010	

Section	Highlights
	Review Board.
Section 15.4	Replaced the referral to the MAP Lender Review Board to referral to the Director of MF Development.
Section 15.8.E	Removed references to Chapter 2, added language for clarity.
Section 15.9.B.6	Clarified the duration or provisions modified in settlement agreements.
Section 15.9.C	Clarified that the MAP Lender's compliance is determined by HUD.
Section 15.15	Removed the term "informal" from this section.
Section 15.15.D	Clarified duration of time before the Appeals Official makes a written determination.
New Chapter	Chapter 16 - Master Lease to facilitate the use of tax credits

CHAPTER 1

SUMMARY OF MAJOR CHANGES IN CHAPTER 1 OF THE MAP GUIDE

Introduction

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement; 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance; 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance; 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance; 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance; 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured; and Section 202/811 Multifamily Projects) Mortgage Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgage Letters from April 2002 through August 2010; and the Housing Economic Recovery Act (HERA) 2008.

Additionally, all HUD forms used in the underwriting of a multifamily project have OMB approval.

Specific Chapter 1 revisions in the new release:

- Section 1.3 adds Sections 231 Housing for the Elderly is a new program added as eligible for processing under MAP. Deleted from the MAP Guide as an eligible program is Section 232, The Residential Care Facilities program has been transferred to Office of Insured Health Care and is no longer eligible for processing under MAP/TAP.
- Section 1.3 added the provision allowing the MAP Lender the option of combining the pre-application and firm application into one stage. The MAP Lender has the option of bypassing the pre-application phase of processing and going straight to the Firm Commitment phase of processing. The time frame for this stage of processing is 60 days.
- Section 1.4 contains a brief summary of MAP and references the programs covered under MAP.

Chapter 1

Introduction

1.1

MAP and the Guide

Multifamily Accelerated Processing, abbreviated as MAP, is designed to establish national standards for approved Lenders to prepare, process, and submit loan applications for Federal Housing Administration (FHA) multifamily mortgage insurance. The MAP Guide provides - in one volume with appendices - mortgage insurance program descriptions, mortgagor and Lender eligibility requirements, application requirements, the underwriting standards for all technical disciplines, and construction administration requirements.

Statutory authority for the implementation of MAP is contained in the basic insuring authority for each of the programs covered in MAP. See National Housing Act, Sections 220, 221(d), and 207. Additionally, Section 211 of the National Housing Act authorizes and directs the Secretary to make such rules and regulations as may be necessary to carry out the provisions of the Act. The FHA requirements listed in HUD regulations covering each MAP eligible program are fully described in the accompanying HUD Handbook or Guide.

1.2

Purposes of MAP

The MAP Guide provides a consistent expedited process at each HUD multifamily Hub or Program Center, (also referred to as Field Offices). HUD no longer accepts new applications for the covered programs, either for pre-application review or for Firm Commitment review, under local “fast-track” processing. The Lender must either submit the application as a MAP submittal, or for traditional application processing (TAP). Under TAP, the HUD Field Office will conduct the due diligence and underwrite. Some MAP-approved Lenders only originate loans. After obtaining a Firm Commitment for loan insurance under MAP, the originating MAP Lender may sell or transfer that Firm Commitment to another MAP Lender. The second MAP Lender handles the construction loan administration and services the loan. At the pre-application, the originating Lender should inform the Hub or Program Center if it does not intend to administer the construction loan, and, therefore, which MAP Lender will be responsible for that function. The second MAP Lender will have to identify their construction loan administrator before or at initial endorsement.

MAP is intended to:

- A. To provide the Lender an earlier review of the application for insurance on new construction and substantial rehabilitation. Therefore, if the application is rejected by HUD at a pre-application stage, the Lender and borrower do not spend the time and money required to prepare the exhibits and analysis for the application for a Firm Commitment.
- B. To establish a process that significantly reduces the amount of HUD review time.
- C. To have in one volume, the MAP Guide, the basic information required for loan origination by the Lender and for review by HUD staff.
- D. To bring Handbook and Notice instructions current and maintain up-to-date instructions through amendments to the MAP Guide.
- E. To strike a careful balance between expedited processing and ensuring an acceptable level of risk for HUD's multifamily mortgage insurance programs.

1.3

Brief Summary of MAP

A. Lender Qualifications and Monitoring

By permitting a MAP Lender to prepare much of the documentation for a loan submission for mortgage insurance, HUD places confidence in the Lender's integrity and competence. Refer to Chapter 15 for the Quality Assurance Enforcement Actions. Lenders wishing to submit MAP applications for FHA Multifamily Mortgage Insurance must:

1. Be an FHA approved lender. See the Mortgagee Approval Handbook (4060.1).
2. Be approved by the Lender Quality Monitoring Division (LQMD) in HUD Headquarters' Office of Multifamily Development. See Chapter 2 of the MAP Guide.

FHA approved Multifamily Lenders who are not approved to submit MAP applications can submit loans for mortgage insurance using traditional (TAP) processing.

B. Programs Covered by MAP

MAP may be used for Sections 221(d) (3) and 221(d) (4) (apartments), Section 220 (apartments in urban renewal areas), Section 231 Housing for the Elderly, and the Section 241(a) Supplemental Loan program. It may be used under Section 223(a)(7) and Section 223(f) for refinancing or purchase of existing apartments. Program requirements for MAP are given in Chapter 3 of this Guide. We will publish program guidance for Sections 223(a)(7) and 241(a) in our future release.

C. Processing

1. For new construction or substantial rehabilitation under Sections 220, 221(d)(3) or (d)(4), 231, and 241(a), an application goes through two stages: a pre-application review and an

application for Firm Commitment review. For refinancing or purchase under Section 223(f); the Lender files an application for Firm Commitment.

2. HUD requires a fee of \$3 per thousand dollars of requested mortgage amount for review of the Firm Commitment application. One half of this amount is due with submission of the Pre-application package for market rate transactions. The entire amount is paid at the Firm Commitment stage for “affordable” New Construction or Substantial Rehabilitation proposals, and for Refinancing or Acquisition transactions. (See Chapter 3 for the definition of “Affordable”).
3. The following is the process for a Lender to submit a MAP application, at both the Pre-application and Firm Commitment stages.
 - a. The Lender has a “concept” meeting or teleconference with the HUD Field Office to discuss the proposed transaction. The exhibits submitted for a concept meeting are detailed in Appendix 4A for New Construction or Substantial Rehabilitation proposals and Appendix 4B for Refinance or Acquisition proposals.
 - b. The transaction is registered with the HUD Field Office. The lender selects and is responsible for performance of the third party due diligence team, and requests approval of the MAP Underwriter. If the HUD has documented concerns about the third party team or the proposed underwriter, the HUD Field Office will contact the Lender Quality Monitoring Division, and if appropriate advise the Lender. Otherwise they will approve the Lender’s underwriter.
 - c. The Lender collects data, processes the loan, performs due diligence, underwrites the loan, obtains internal loan approval (from the Lender’s loan committee or other process), and submits the loan and application fee to HUD.
 - d. The HUD Field Office staff read the Lenders Underwriting Narrative and screens the application. This preliminary technical review is to determine if the application is complete and that there are no material deficiencies or obvious deal points not addressed in the application. Assuming, after review of the Lender’s Underwriting Narrative and screening, the Field Office determines the application is complete and ready for processing; they will cash the check for the application fee and continue the technical review. If there are material deficiencies identified, the Field Office will discuss the issues with the Lender and document the issues in an e-mail or more formal correspondence. If the issues can be and are corrected within 1 week, the Field Office will continue processing. If the issues are such that they cannot be quickly corrected, the application should be returned to the Lender.

4. Standard Processing Times

The time frames for HUD MAP processing listed below have been established to assure timely decision making on FHA applications.

a. Pre-application Review (New Construction/Substantial Rehabilitation) – 45 days.

The performance standard for this stage is no more than 45 days. This stage of MAP is measured in calendar days; it begins when HUD receives a **complete** pre-application

from an approved MAP Lender and ends when HUD issues a signed letter that advises the Lender whether to apply for a firm commitment.

- b. Firm Commitment Application Review (New Construction/Substantial Rehabilitation) - 45 days.

The performance standard for this stage is no more than 45 days. This stage of MAP is measured in calendar days; it begins when HUD receives a complete firm commitment application and ends when HUD issues a signed commitment.

The MAP Team Leader may extend this review period under certain circumstances as described in Chapter 11, Section 11.2. Lenders will be advised immediately if the Team Leader determines that a more extensive review is needed.

- c. Firm Commitment Application Review (Existing Property Purchase or Refinance) – 60 days.

The performance standard for this stage is no more than 60 days because there is no pre-application review for Existing Property Purchase or Refinance applications. This stage of MAP is measured in calendar days; it begins when HUD receives a complete firm commitment application and ends when HUD issues a signed firm commitment letter.

- d. Combined Pre-application & Firm Commitment application - 60 days.

Where the MAP Lender has opted to combine the pre-application and firm application stage for an “affordable” transaction, the performance standard for this stage is no more than 60 days. This stage is measured in calendar days; it begins when HUD receives a complete application that includes all of the exhibits previously required at pre-app with the exhibits required for firm commitment processing. This 60 day time Field Office review time frame is only when the pre-application phase is combined into the one Firm Commitment application phase.

5. Responsibility for Underwriting and Technical Review

This Guide discusses the Lender’s responsibilities and HUD’s review responsibilities. Chapter 4 discusses Processing, Chapter 5 discusses the Architectural responsibilities, Chapter 6 covers Construction Cost, Chapter 7 describes Valuation, Chapter 8 Mortgage Credit, Chapter 9 Environmental Requirements, Chapter 10 Management Analysis, and Chapter 11 discusses Underwriting.

6. HUD has certain responsibilities, which, by law or regulation, it does not assign to the Lender. For example, HUD is responsible for the environmental clearance on HUD Form 4128 (even though the Lender prepares the information). HUD must approve the owner’s Affirmative Fair Housing Marketing program. HUD issues the commitment for mortgage insurance.

D. Construction Responsibilities

Under MAP, HUD approves the initial and final draws utilizing current procedures. The MAP Lender prepares and approves the documents required for the interim draws during construction. HUD will perform inspection duties and will give copies of the Trip Report to the MAP Lender.

HUD also retains the right to approve the construction amount for each item in the initial and final advance and each Change Order during construction.

E. No New Requirements for Servicing

MAP makes no changes in current procedures for servicing or asset management. A MAP Lender is not required to service the loan it originates. The Loan Servicer to whom a MAP loan is transferred must be FHA-approved for multifamily housing, but it need not be a MAP-approved Lender.

1.4

Relation of MAP to Handbooks and Notices

- A.** All applicable HUD Handbooks, Notices, and Forms remain in effect. They will be used for traditional HUD processing of mortgage loan applications. For applications under MAP, the MAP Guide incorporates the majority of Handbook, Notice, and Form requirements. It includes in the Appendix the forms that are required for the customary applications. Certain forms and requirements that are infrequently used or are too detailed for inclusion in this Guide are incorporated by reference to the Handbooks, Notices, and Forms, statutes or regulations. If there is a conflict between the MAP Guide and the Handbooks, the MAP Guide will take precedence. Questions on conflicts should be raised to the HUD office processing the Lender's application. Where the MAP Guide is silent on a matter, old requirements are obsolete. Rather consult with HUD Headquarters at the following MAP website:
<http://www.hud.gov/offices/hsg/mfh/map/maphome.cfm>.
- B.** The MAP Lender must be familiar with Sections 207, 220, 221(d) (3), 221(d) (4), 223(f), and 231 of the National Housing Act. The Lender should also understand the regulations for those sections of the Act and the basic program requirements set forth in 24 Code of Federal Regulations Part 200.
- C.** The MAP Lender is encouraged to contact a Multifamily Hub office if it encounters any issues that are not addressed in the Guide or if it wishes clarification of any instructions contained in the Guide. Chapter 11 "Underwriting" of this Guide covers waivers. The Multifamily Hub Director retains the right to waive non-regulatory or non-statutory provisions of the Guide, but Chapter 11 specifies a limited number of requirements that may not be waived without prior approval from HUD headquarters. Regulatory provisions may be waived only on specific approval of the Assistant Secretary for Housing - FHA Commissioner. Statutory provisions may not be waived.
- D.** Any waiver of this Guide granted by the Hub Director in connection with the proposed transition must be documented in the field office docket and Washington docket, along with the Lender's request and field office request. Waivers granted at the Hub level must be submitted, along with supporting documentation, to the Office of Multifamily Housing Development, Attention: Lender Monitoring Division for post review. Headquarters will review all waivers requested and granted to determine if changes to this guide or the regulations are necessary.

1.5**Work Management**

- A. Applications for mortgage insurance should be submitted to the MAP Coordinator in the Hub having jurisdiction in the area where the property is located. The Hub Director is responsible for workload management within their Hub, including: Delegation and staff assignments,
 - 1. Priority of application processing,
 - 2. Meeting standard processing times, and
 - 3. Loan Committee.

- B. Responsibilities assigned by this Guide to a Hub Director or Program Center Director may be delegated unless specifically restricted by this Guide or by regulation.

CHAPTER 2

SUMMARY OF MAJOR CHANGES IN CHAPTER 2 OF THE MAP GUIDE

Lender Qualifications

Chapter 2 has OMB Clearance under 2502-0541

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

Other than minor revisions in 2001 and 2002 the MAP Guide has not been revised since it was originally published in May, 2000. The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgage Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgage Letters from April 2002 through August 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 2 revisions in the new release:

- Renamed Chapter to “Lender and Underwriter Qualifications”
- Added Tiered Approval parameters to Section 2.1
- Section 2.3a contains the New MAP Lender Requirements
- Section 2.3b contains the New MAP Lender Application Requirements
- Section 2.4a contains the new MAP Lender Underwriter approval requirements
- Section 2.4b contains the new MAP Lender Underwriter Applications Requirements
- Section 2.4c contains the Existing MAP Lender Underwriter Trainee Requirements
- Section 2.4d contains the Existing MAP Lender Underwriter Trainee Application Requirements
- Previous Sections 2.10 thru 2.15 were removed and placed in a separate chapter, Chapter 15 to contain all of the Enforcement actions.
- Section 2.10 now address the role of Loan Brokers and Correspondents

Lender and Underwriter Qualifications

2.1

Introduction

- A. Multifamily Accelerated Processing requires Lenders skilled in underwriting multifamily housing loans and in the preparation of an application for FHA multifamily mortgage insurance. To provide HUD some assurance that MAP Lenders are qualified for their responsibilities, MAP requires a Lender to be approved by HUD's Lender Qualification and Monitoring Division (LQMD) of the Office of Multifamily Housing Development.
- B. Approval of a MAP Lender by LQMD is on a nationwide basis, so that the MAP Lender may apply to process loans using MAP regardless of which HUD Multifamily Hub or Program Center will be processing the loan. By accepting the opportunity to use MAP, a MAP Lender agrees that its MAP loans will be subject to post-endorsement review by the LQMD. Moreover, the MAP Lender agrees that if it fails to meet HUD standards for underwriting loans, its MAP designation may be terminated. Qualification is continuing unless terminated in accordance with the Quality Assurance Enforcement Actions in Chapter 15.
- C. The tiered levels of approval and experience requirements for each are:

	Approved Programs	Experience Requirements
Tier 1	223(f) and 223(a)(7) with no Government Subsidies or LIHTCs	5 Closings
Tier 2	223(f) and 223(a)(7), with or without Government Subsidies or LIHTC	5 Closings Total; 2 may be credited from Tier 1
	Approved Programs	Experience Requirements
Tier 3	220, 223(f), 223(a)(7), 221(d), 231, 241 with no Government Subsidies or LIHTCs	5 Closings
Tier 4	220, 223(f), 223(a)(7), 221(d), 231, 241, with or without Government Subsidies or	5 Closings Total, 2 may be credited from Tier 3

As it relates to tiered approvals, Government subsidies shall include LIHTC's, Section 8 rental assistance, Project Rental Assistance Contracts, rent restricted bond financing, Section 236 Interest Reduction Payments and all other similar forms of subsidy.

- D. Approval of a lender and underwriter by LQMD is on a nationwide basis, so once approved the lender and underwriter may submit applications regardless of which Hub or Program Center will be processing the loan or where the project is located. The names of approved lenders and underwriters, and their approval level, will be posted on HUD's website. As a condition of approval the lender and underwriter agree that their loans will be subject to post-endorsement review by the LQMD. Moreover, the lender and underwriter agree that if they fail to meet HUD standards for underwriting loans, their designation or approval level may be terminated or downgraded in accordance with all applicable monitoring and enforcement provisions.
- E. Approval by LQMD as a MAP Lender is a prerequisite for the Lender, but MAP approval does not obviate the need to have an experienced team on each application.
1. Each time that a MAP Lender applies for mortgage insurance on a multifamily loan, the HUD office reviews the qualifications of the Lender's principal staff members or consultants who will be reviewing or preparing the borrower's loan application. Principal staff and consultants means the Lender's staff underwriter who will sign the underwriting summary, the person who will prepare the appraisal and market study, the person who will review the cost figures, and the person who will review the developer's architectural plans and specifications. The Lender should also verify that the person who will prepare the environmental assessment is a qualified professional. This consultant is not one of the third party contractors that are subject to HUD approval. Refer to Chapter 9, Section 9.2 for qualifications of professionals. If a Hub has previously approved a member of the Lender's staff or a contractor, the Lender is required only to submit the names of the staff or contractor and note the prior approval. The Hub or Program Center retains the right to reject, for reasons given in writing, any member of the Lender's team for the particular loan application. The technical chapters of this Guide discuss reviewer's qualifications. Once a member of the Lender's staff, or a third party contractor, has been approved by one of the Department's Hubs, the Lender need only submit the names of the staff or contractor and note this prior approval. This does not, however, give the Lender the authority to use an appraiser that is not competent or not properly certified in the appropriate jurisdiction. The Lender must insure that every appraisal contractor for every application meets all requirements as outlined in Map Guide Chapter 7, Section 7.3, especially the USPAP Competency provision and jurisdictional certification requirements.

2. Names and resumes of the appraiser and/or market analyst should be submitted as soon as possible prior to the pre-application. The names of the architectural analyst and cost analyst should be submitted prior to the application for a Firm Commitment. For refinancing or purchase, the appraiser's resume should also be submitted prior to the application for the Firm Commitment. HUD has up to ten business days, after receipt of the names, to reject any principal staff member or consultant. If there is no notice from HUD within those ten business days, the names are approved.
- F. This Chapter covers, in Sections 2.2 – 2.7, the requirements imposed on Lenders so that they qualify to submit applications as MAP Lenders. Sections 2.8 – 2.9 briefly discuss the post-endorsement monitoring of MAP loans.
- G. Sale or Transfer of a MAP Application: The originating MAP Lender may sell or transfer a MAP application only upon receipt of a Firm Commitment. The application may only be sold to another MAP approved Lender not currently subject to any suspension or Limited Denial of Participation penalties.

2.2

Lender Qualifications

- A. Lender MAP approval requests should be sent to:

Lender Qualifications and Monitoring Division

Office of Multifamily Development

Room 6138

451 7th Street, SW

Washington, DC 20410

FAX Number: 202-401-9087

- B. The Lender prepares the application for approval as a MAP Lender. There is no required form for this application. Upon receipt of all the information specified in Section 2.3b, LQMD has a goal of 30 days to act on the application.
- C. The Director of the Office of Multifamily Development will approve in writing each MAP Lender. The names of approved Lenders are posted by LQMD on the Internet.
- D. LQMD may, instead, disapprove an application on the grounds that it has failed to meet the standards set forth in Section 2.3a of this chapter or that it has failed to provide sufficient information required in Section 2.3b of this chapter. LQMD also may decide not to allow the Lender to participate in the MAP program until specified deficiencies are corrected. An appeal of a decision by LQMD and The Director of the Office of Multifamily Development to disapprove an application may be made to the Deputy Assistant Secretary for Multifamily Housing.

- E. If the Lender's approval has been terminated, the Lender may not reapply for 12 months after termination. (See Chapter 15, Section 15.8.E) The Lender has the ability to appeal its termination as stated in Chapter 15, Section 15.15.
- F. At the discretion of the Director of the Office of Multifamily Development, a lender may be granted Probational MAP Approval. Probationally approved MAP Lenders shall remain on Probational status until they demonstrate acceptable standards of practice as determined adequate by the Director of the Office of Multifamily Development

2.3a**Standards Required for Qualification for New MAP Lenders**

- A. To qualify, the lender must:
 - 1. Be an FHA-approved multifamily mortgagee, and meet all applicable capital and liquidity requirements,
 - 2. Have on staff a principal employee or employees with multifamily underwriting experience commensurate with the approval level requested, and
 - 3. Have a satisfactory record with FHA-insured and/or conventional Multifamily lending commensurate to the approval level requested. Evidence that the lender is an FHA-approved multifamily mortgagee and that it is current on its financial reporting must be submitted with the application.
- B. The lender must not be subject to judgments in administrative claims or lawsuits which would seriously affect its ability to do business, and must not unlawfully discriminate in employment or in lending practices.
- C. For any loan to be processed under MAP, the lender must thoroughly understand the applicable mortgage insurance program requirements. Therefore, the lender must have on staff persons with underwriting experience commensurate to the approval level requested during the 3 year period immediately preceding the date of application. Loan underwriting completed up to 5 years preceding the application date will be acceptable for Approval Tier Levels Two and Four
- D. During the applicable 3 or 5 years, the lender must have worked regularly in the multifamily lending business and must have underwritten and closed at least five loans commensurate to the tier level requested. For lenders applying for Tier 2 approval, two of the required five loans may be credited from Tier 1. For lenders applying for Tier 4 approval, two of the required five loans may be credited from Tier 3. The lender can demonstrate acceptable experience with affordable housing lending using the LIHTC program even if the transaction did not use an FHA insured loan. Closings with other Government Sponsored Entities (GSE), with Local or State Housing Finance Agencies (HFAs) or with conventional financing is acceptable, if the extent and quality of the underwriting can be ascertained. Specifically, to be awarded credit for GSE, HFA or

conventional loans, the underwriting and loan processing must be similar to that performed under the MAP process.

- E. To be awarded experience credit for a loan closing, the loan must:
1. Have closed and been fully funded (for FHA loans, fully funded shall mean Finally Endorsed),
 2. Not have experienced an early claim or early default (defined as a claim or default within 3 years of Final Endorsement), and
 3. Have been acceptably underwritten, based upon input from the FHA processing office or the appropriate GSE.
- F. The lender must identify those persons who will have the authority to underwrite loan applications under MAP and to sign the narrative summary. The lender must also identify those individuals whose signatures may bind it for any of its program responsibilities and mortgagee certifications.
- G. FHA multifamily lending experience is not specifically required for initial approval. If the lender lacks FHA experience, emphasis will be placed on its recent conventional or GSE multifamily lending experience that is concluded to be equivalent to the level of approval requested, and the processing was commensurate to what would be performed under MAP.
- H. Lenders that are deemed to have an adequate conventional/GSE/HFA lending background but no prior FHA experience may be granted approval on a probationary basis for 1 year. Probationary lenders will be re-evaluated after their first year in the program based on a review of the quality of their underwriting and application submissions to determine if the lender will be granted permanent approval, or subjected to additional probationary requirements. At the discretion of the Director of the Office of Multifamily Development, probationary lenders may be limited in the number of applications they may submit or in the dollar amount of commitments they will be authorized to underwrite.
- I. TAP or MAP-like experience may be considered in cases in which the applicant documents underwriting activity analogous to what would be performed under MAP. A lender with prior FHA experience must submit a list of the Hubs and Program Centers with which it has worked in the previous 3 years. LQMD will contact those Hubs and Program Centers to ascertain their experience with the applicant. A pattern of unsatisfactory applications at one or more Hubs or Program Centers may be grounds for rejection of the applicant, or rejection at the approval level requested. A recent history of assignments of FHA-insured loans may also result in rejection. LQMD will examine the reasons for a default and assignment to determine if the applicant was at fault for originating a loan that did not perform satisfactorily.
- J. When HUD Headquarters is advised by a Hub or Program Center of any training, it will be posted on the MAP home page website under MAP Underwriting training at <http://www.hud.gov/offices/hsg/mfh/map/maptraining.cfm>.

2.3b**New Lender Application Package**

The lender's application for approval must be submitted to LQMD and should include the following:

- A. Name of applicant, address, employer identification number, contact person or persons, telephone and fax number, e-mail address, branch offices for multifamily business with address, telephone and e-mail address, and the FHA Mortgagee ID Number.
- B. List of names and titles of those who are authorized to bind the lender in matters involving an application, underwriting and origination of FHA insured mortgages under MAP.
- C. Type of mortgagee (e.g., supervised or non-supervised), type of ownership structure (e.g., general corporation, limited liability corporation, partnership, housing finance agency or other), whether or not the mortgagee is a subsidiary of another company, and if so, identification of the parent company.
- D. Copy of Letter of Approval/HUD approval Form HUD-92001 evidencing approval as an FHA Approved Multifamily Mortgagee.
- E. Narrative discussion of the applicant's multifamily lending operations, including:
 1. Whether it acts as a loan originator and servicer, or as an originator selling its commitments or loans to others,
 2. Whether it originates loans to hold in its portfolio, or purchases loans from others,
 3. Its experience in construction loan administration,
 4. The number, location and staffing of branch offices it operates,
 5. Description of business relationships with brokers or correspondent lenders, and
 6. Any other information the applicant deems relevant in providing a clear picture of its multifamily business operations and capacities.
- F. Experience of the applicant in multifamily loan origination, for both conventional and FHA insured loans. List the FHA insured loans for which applicant has received Firm Commitments in the last 5 years, including:
 1. The number, name, location, original principal amount, and HUD Office where processed,
 2. Whether the loan is in default, and
 3. If the loan has been assigned to FHA.

Default for this purpose means a loan for which payments are more than 60 days overdue, and includes properties in rolling default. The extent of conventional multifamily lending may be summarized rather than listing each conventional mortgage originated in the last 5 years. It is important to include the extent to which construction financing was involved, and the number and percentage of defaults and foreclosures in the conventional multifamily loans the lender has originated. List any FHA or conventional loans that were sold since origination and are serviced by another lender.

- G. Narrative discussion explaining any elections to assign FHA loans for insurance benefits for any Initial Endorsement after May 1, 2002.
- H. Resumes of the lender's staff responsible for underwriting MAP loan applications which demonstrate that the staff has been or will be approved as new MAP underwriters in accordance with the requirements of this Notice.
- I. Experience in construction loan administration if the applicant is intending to participate in construction lending under MAP Approval Levels Three or Four. Identify those persons authorized to sign advances, construction change orders and escrow releases. Describe the applicant's construction lending processes and procedures for handling construction draws, change order requests, cost certification review, and resolution of disputes during construction.
- J. Information regarding: Lawsuits/claims/judgments filed or issued in the last 3 years against the applicant which:
 - 1. Concern equal employment or lender discrimination prohibited by law, or
 - 2. Are a result of, or might significantly affect, its multifamily lending business. Any criminal charges brought against the applicant related to the mortgage lending business.
- K. Disclosure of any warning or compliance deficiency letters from regulatory agencies with monitoring jurisdiction over the lender's activities.
- L. Confirmation that the lender will certify with each application for mortgage insurance that it is in compliance with the identity-of-interest provisions in the MAP Guide which provide that, "No financial or family relationship is permitted between an officer, director or partner of the MAP Lender, its principal staff or contract employees working on a particular application and an officer, director or partner of the sponsor, the mortgagor, the principals of the mortgagor, the general contractor, subcontractors or seller of the land or property."

- M. Agreement that the lender will provide access to its files and records on FHA applications for monitoring by HUD staff, including the LQMD and the Office of Inspector General.
- N. Quality Control Plan for underwriting and construction loan administration, if applicable, of insured mortgages processed under MAP procedures. The plan must include an organization chart documenting the lender's delineation of responsibilities between underwriting, origination and other related lending activities.

2.4a**MAP Lender Approval Requirements for New MAP Lenders**

- A. Underwriters must be full time employees of the approved lender. An underwriter must attend a MAP training session before submitting an application or pre-application. When HUD Headquarters is advised by a Hub or Program Center of any training, it will be posted on the MAP home page website under MAP underwriting training at: www.hud.gov/offices/hsg/mfh/map/maptraining.cfm.
- B. During the 5 years preceding an underwriter's application for approval, the underwriter must have worked full time in the multifamily lending business and have underwritten at least five loans which have actually been funded and are commensurate to the Tier level requested. For underwriters applying for Tier 2 approval, two of the required five loans may be credited from experience commensurate to Tier 1. For underwriters applying for Tier 4 approval, two of the required five loans may be credited from experience commensurate to Tier 3. Similar to lender approvals, the underwriter's experience with affordable housing lending using LIHTC programs need not be exclusively in conjunction with FHA program experience.
- C. For the underwriter to be awarded experience credit for a loan closing, the loan must:
 - 1. have closed and been fully funded,
 - 2. not have experienced an early claim or early default (defined as a claim or default within 3 years of Final Endorsement), and
 - 3. have been underwritten acceptably based upon input from the processing Multifamily Hub or the appropriate GSE.
- D. If the underwriter lacks FHA experience, emphasis will be placed on recent conventional or GSE multifamily lending experience that is equivalent to the level of approval requested, and the processing was commensurate to what would be performed under MAP. FHA experience should be based on MAP processing. TAP experience may be considered on an exception basis for a minority of loans in cases the applicant documents underwriting activity analogous to what would

be performed under MAP. Appeals of rejections may be submitted to the Deputy Assistant Secretary of Multifamily Housing. An underwriter may appeal a decision to disapprove an application to the Deputy Assistant Secretary for Multifamily Housing.

2.4b**Underwriter Application Requirements for New MAP Lenders**

The information submitted to LQMD should include the following:

- A. Resume of the underwriter. The underwriter's resume must demonstrate the specific qualifications, education and the necessary level of experience as outlined above and a MAP training certificate.
- B. List of loans processed and underwritten for which commitments were issued. The list must be certified and signed by a senior officer of the MAP Lender with authorized signatory designation and the underwriter trainee. The certified list must contain the following:

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than 5 years or both.

- C. Complete documentation of each loan submitted for experience credit. The following documentation properly signed by the underwriter should be provided:
 1. A narrative analysis which clearly identifies the specific tasks performed by the underwriter.
 2. A copy of completed forms and/or exhibits for the type of mortgage proposed that require mortgage credit analysis.
 3. An Identity-of-Interest Certification signed and dated by the underwriter, in the following format:

I am employed full time by the MAP Lender and that I have no other side deals, agreements, or financial considerations with the MAP Lender or others in connection with this transaction.

_____ Signature

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than 5 years or both.

4. Disclosure of any disciplinary warning letters from regulatory agencies with monitoring

jurisdiction.

2.4c**Underwriter Trainee Requirements for Existing MAP Lenders**

- A. The lender must establish a written development plan for underwriter trainees. The development plan must include a combination of commercial/multifamily training courses and on the job experience. The underwriter trainee must have successfully completed at least three underwriting, finance or appraisal courses that demonstrate basic understanding of multifamily underwriting concepts, one of which must be a multifamily appraisal course. The coursework must be completed within 5 years of the date of application. Architectural and cost knowledge may be obtained through practical experience with the lender's architectural reviewer or through an acceptable training institution. LQMD may consider waivers of some of the education requirements for persons deemed to have equivalent experience.
- B. In addition to the training courses, HUD requires on the job training of a minimum of 3 years of continuous work experience in multifamily mortgage lending or servicing within the past 5 years. The underwriter trainee must work on a minimum of five MAP projects that reach endorsement; this requirement may not be waived. For underwriter trainees applying for Tiers 2, 3 and 4, 2 of the closings can be credited from a lower tier.
- D. Only one underwriter trainee may assist the MAP approved underwriter in completion of the transaction. All the transactions used to meet the on-the-job training experience requirement should clearly identify the approved underwriter who acted as mentor.
- E. The underwriter trainee must be a full time salaried employee of the lender. The trainee cannot be hired on a contract basis for a particular loan application.
- F. To get experience credit for the closings, the relevant responsibilities are:
 - 1. The MAP approved underwriter is primarily responsible for and must complete and sign the narrative summary and the HUD processing forms. The trainee must assist the underwriter in completion of the underwriting. Both the underwriter trainee and the MAP underwriter must sign the narrative and the HUD processing forms, and the trainee's contribution must be acknowledged. The specific tasks performed by the trainee should be clearly stated in the narrative.
 - 2. The trainee assists, however the approved underwriter must accept full responsibility for all aspects of the underwriting process for the transaction.
 - 3. Work products completed by an underwriter trainee must be completed under the direct supervision of the approved underwriter. It is unacceptable for the underwriter to merely

sign a form or document prepared by an underwriter trainee without providing proper supervision. The mentor underwriter must add a paragraph in the Underwriter Certification to certify that he/she has directly supervised the underwriter trainee in completion of the specific tasks identified in the narrative and the HUD processing forms.

2.4d**Application Requirements for Underwriter Trainees for Existing MAP Lenders**

The request for approval of a trainee as a MAP underwriter should be submitted to LQMD by a senior officer of the MAP Lender with signatory authority and include:

- A. Written development plan established by the lender for the underwriter trainee.
- B. Resume of the underwriter trainee. The trainee's resume must demonstrate the specific qualifications, education and the necessary level of experience as outlined above and a MAP training certificate.
- C. List of loans processed and underwritten by the trainee for which FHA Firm Commitments were issued. The list must be certified and signed by a senior officer of the lender with authorized signatory designation and the underwriter trainee. The certified list must contain the following:

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than 5 years or both.

- F. Complete documentation of each loan submitted for experience credit. The following documentation properly signed by the trainee and co-signed by the mentor approved underwriter should provide:
 1. A copy of narrative which clearly identifies the specific tasks performed by the underwriter trainee.
 2. A copy of completed Form HUD-92264-A and other forms and/or exhibits for the type of mortgage proposed that require mortgage credit analysis.
 3. A copy of the HUD-92264 or HUD 92264 HCF.
 4. An Identity-of-Interest Certification as previously stipulated in this section, signed and dated by the underwriter trainee only.

2.4e**Underwriter Transfers**

- A. Underwriter approval does not automatically entitle the underwriter to transfer from one lender to another. Upon leaving their place of employment, the underwriter must re-apply for approval under the new lender. At that time, the underwriter's performance history with FHA

will be evaluated. Underwriters found to have:

1. Excessively high early claim or default rates,
2. Unresolved findings, or
3. Unresolved enforcement actions,

will not be re-approved, or they may be re-approved at a lower approval level than they had been approved at before. Underwriters may not apply for transfer approval for a period of 12 months from the date of their most recent approval.

B. The following exhibits must be submitted by previously approved underwriters to support a request for re-approval:

1. Written request for re-approval submitted by a senior officer of the lender with signatory authority, confirming the underwriter's employment and requesting that the underwriter be re-approved.
2. Updated resume of the underwriter.
3. List of all loans processed and underwritten by the applicant since they were originally approved as an underwriter. The list must be certified and signed by the applying underwriter. The certified list must contain the following warning:

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than 5 years or both.

4. Copy of the underwriter's prior approval.
5. Written analysis of any applications processed by the underwriter that resulted in a default or a claim for mortgage insurance. The analysis should include an assessment of the factors that contributed to the default or claim, and a discussion of whether the quality of the underwriter's work was a contributing factor.

2.5

Electronic Capability and Internet Access

HUD will post information on the Internet and will transmit messages to Lenders and to the lending community by e-mail, often with attached documents. Much of the information required by HUD may be submitted electronically. Therefore, it is a requirement that the Lender have Internet access and the capability of receiving and sending documents.

2.6

Identity of Interest

- A. No financial or family relationship is permitted between an officer or partner of the MAP Lender, its principal staff or contract employees working on a particular application and, an officer, Director, or partner of the sponsor, the mortgagor, and the principal of the mortgagors, the general contractor, subcontractor, or the seller of the land or property.
- B. An affiliate of a MAP Lender can be the tax credit syndicator and own an interest in the mortgagor entity under the following conditions:
 - A. In all instances where there is an identity of interest between the MAP Lender and the tax credit syndicator, a request for authorization must be submitted to the HUD field office with jurisdiction for each separate project being processed.
 - B. The affiliated tax credit syndicator will hold no more than a one percent interest in the mortgagor entity. During the interim period in which the affiliated tax credit syndicator is holding the syndicated ownership interests for sale to the investors, the percentage may be higher but when the interest are sold, the affiliated tax credit syndicator or any affiliate or subsidiary of the tax credit syndicator may not own more than one percent of the mortgagor entity. The reason to allow the nominal ownership interest in the mortgagor entity by the syndicator is that ownership of even a small amount assists the tax credit syndicator in the due diligence required for the tax credit investors. The tax credit syndicator exercises due diligence to ensure that the project's financing, ownership, management and compliance are satisfactory to the investors and certain regulatory agencies. The tax credit syndicator and mortgagor are interested in seeing that the sale of the tax credits is processed and administered smoothly and correctly.
 - C. If a potential serious problem arises in a syndicated tax credit project, the tax credit syndicator or its legal nominee, as part owner of the mortgagor, would have the legal standing to step into the shoes of the general partner and remedy any problem that might jeopardize their rights or expose them to liability. HUD has the same interest as the tax credit syndicator does in keeping the project fiscally current.
- 4 HUD has the responsibility of ensuring that the affiliated tax credit syndicator does not improperly influence the MAP Lender. Therefore, the MAP Lender and the affiliated tax credit syndicator each must provide the HUD field office specific Representations and Warranties on each case submitted. The representations and Warranties must be signed, dated and contain the criminal warning language found in item 5. below.
 - a. The MAP Lender's Representation and Warranty must state:

With respect to any loan that it will underwrite under MAP:

 - i. No officer or employee of _____ (insert the name of affiliated tax credit syndicator) or any director or direct or indirect parent thereof will have any loan-specific control or influence in _____'s (insert the name of MAP Lender) underwriting of the MAP loan (except by providing factual information to _____ (insert the name of MAP Lender) in the same manner as would be provided by an unaffiliated syndicator).

- ii. _____(insert the name of MAP Lender) will not condition its commitment to provide such financing on _____ (insert the name of affiliated tax credit syndicator) being selected as the tax credit syndicator for the project to be financed by the MAP loan.
 - iii. _____ (insert the name of MAP Lender) will notify HUD promptly in writing in the event of any change or event, which causes any of the foregoing Representations or Warranties to be materially untrue or inaccurate.
- b. The MAP Lender’s affiliated tax credit syndicator’s Representation and Warranty must state:
- i. In the regular course of its business it syndicates tax credit investments in owners of multifamily affordable housing projects.
 - ii. With respect to any project loan that is to be underwritten by _____(insert name of MAP Lender) and that _____(insert name of affiliated tax credit syndicator) intends to syndicate to tax credit investors:
 - iii. No officer or employee _____(insert name of MAP Lender) will have any loan-specific control or influence in _____’s (insert name of affiliated tax credit syndicator) processing of the owner’s application for tax credit syndication (except by providing factual information to _____ (insert the name of affiliated tax credit syndicator) in the same manner ad would be provided by an unaffiliated lender).
 - iv. _____ (insert the name of affiliated tax credit syndicator) will not condition its commitment to syndicate the project on debt financing for such project being provided by _____ (insert the name of MAP Lender).
 - v. Except during the interim period in which _____ (Insert name of affiliated tax credit syndicator) is holding the syndicated ownership interests in the mortgagor entity for sale to investors, neither _____ (insert the name of affiliated tax credit syndicator) nor any affiliated or subsidiary thereof will hold an ownership interest in the mortgagor other than a nominal (one percent or less) ownership interest.
- 5 The Representations and Warranties must include the following criminal warning language: WARNING: “HUD will prosecute false claims and statements. Convictions may result and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)”
- 6 HUD field offices cannot waive or modify the above Representations and Warranties without first obtaining written permission of the Office of Multifamily Development.
- C. Identity of Interest issues can be considerably complex and require a great deal of research to be properly answered. If there is a question about whether or not there is an identity of interest

between the Lender and the mortgagor, contractor, and others, all questions and supporting documentation must be submitted to:

Lender Qualifications and Monitoring Division
Office of Multifamily Development
Room 6138
451 7th Street, SW
Washington, DC 20410
FAX Number: 202-401-9087

2.7**Limitation on Requirements**

- A. There is no requirement for additional net worth requirements for a MAP Lender. All FHA-approved multifamily Lenders must have an adjusted net worth of not less than \$250,000.
- B. There is no fee required by HUD for qualifying (or deciding not to qualify) a MAP Lender.
- C. There is no requirement that approved MAP Lenders notify LQMD if there has been a staff change. MAP Lenders are expected to maintain or improve the level of experience or the number of experienced staff members. The LQMD does not approve or disapprove of individuals working for MAP Lenders, but expects the MAP Lender to be certain that its staff meets the qualifications. If, for example, the Lender loses its staff underwriter, it must immediately replace him or her.
- D. MAP Lenders must notify LQMD if there has been a change of address of the home office for multifamily business, e-mail address, telephone number, ownership, or if the Lender has a material change in the way of doing business. MAP Lenders must also notify LQMD if they withdraw as MAP Lenders, whether temporarily or not.

2.8**Agreement to Accept Monitoring**

The applicant for MAP Lender approval agrees that, if it is approved, it will make its files and records available to HUD or HUD's authorized contractors for such monitoring of MAP processed loans as HUD wishes to make. The Lender should maintain the origination files for three years even though the loan itself may be sold to another entity.

2.9**Monitoring by LQMD**

- A. MAP Lenders are subject to monitoring and periodic on-site reviews by LQMD to verify for MAP HUD committed loans in processing by the Lender or HUD endorsed that:
 - 1. The Lender adheres to statutory, regulatory and the MAP Guide requirements.

2. The Lender's underwriting decisions are consistent with HUD requirements in the MAP Guide.
 3. The Lender's technical processing is consistent with HUD requirements in the MAP Guide.
 4. The Lender has complied with the conditions of the Firm Commitment and the requirements of initial endorsement (and final endorsement).
 5. The Lender has complied with the requirements of construction loan administration set forth in the MAP Guide.
- B. LQMD will not begin reviews of origination documentation until after the Lender's first MAP Firm Commitment has been endorsed for mortgage insurance. Any loan may be reviewed for up to three years after final endorsement.
- C. If there has been fraud or misrepresentation, HUD reserves its legal rights under the contract of mortgage insurance and Mortgagee Review Board requirements.
- D. The review by LQMD is not a substitute for other periodic audits and reviews by HUD, including a financial management review and a review of the Lender's quality control plan as required by HUD Handbook 4060.1 "Mortgagee Approval Handbook."

2.10a**Upgrading Tiered Approval for MAP Lenders**

- A. A lender authorized at a lower approval level that wishes to apply for approval at a higher tier level must meet the same requirements as a new lender which is applying for authorization at that higher approval level.
- B. Materials that must be submitted to LQMD to support the lender's application for a higher approval level are listed in Section 2.3b of this Chapter, but include only the materials listed at letters F, G, H, I, J, K and M.
- C. As with a new lender, non-FHA insured loans can be used to demonstrate the lender's expertise and qualifications at the higher approval level.
- D. The lender's upgraded tier approval will be on a probationary basis until they demonstrate satisfactory performance at the upgraded tier for a total of three (3) fully funded closings.
- E. Lenders that fail to demonstrate satisfactory performance at the upgraded tier may have their probation period extended or they may be downgraded to the lower tier for which they were previously approved.

2.10b**Upgrading Tiered Approval for MAP Underwriters**

An underwriter authorized at a lower approval level must work as a trainee on applications under the more

complex insurance programs with a mentor underwriter who is already authorized at the higher approval level, so as to obtain authorization as an underwriter at the higher level in their own right. Upgrading to a higher approval level requires the underwriter/trainee to work on at least three applications at the higher level, for which the loans closed. The request for an upgraded approval level should be submitted to LQMD by a senior officer of the lender with signatory authority, and must include:

- A. Resume of the underwriter/trainee. The resume must demonstrate the specific qualifications, education and the necessary level of experience as outlined in Section VI, above, Approval of New Underwriters, and a MAP training certificate.
- B. List of loans processed and underwritten by the underwriter/trainee for which FHA Firm Commitments were issued and the loans closed. The list must be certified and signed by a senior officer with authorized signatory designation and by the underwriter/trainee. The certified list must contain the following warning:

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than 5 years or both.

- C. Documentation of each application submitted for experience credit. The following documentation, signed by the underwriter/trainee and co-signed by the mentor approved underwriter employed by the same lender, must be provided:
 - 1. Copy of Underwriter's Narrative which clearly identifies the specific tasks performed by the underwriter/trainee in the Narrative Summary.
 - 2. Copy of completed HUD Form 92264-A and other forms and/or exhibits for the type of loan proposed that required mortgage credit analysis. (Reference MAP Guide, Chapter 8 and Appendix 4)
 - 3. Copy of the HUD-92264 or HUD 92264 HCF.
 - 4. Identity-of-Interest Certification as stipulated in MAP Guide, paragraph 11.2.M signed and dated by the underwriter/trainee only.
- D. The underwriter's upgraded tier approval will be on a probationary basis until they demonstrate satisfactory performance at the upgraded tier for a total of three (3) fully funded closings. Underwriters that fail to demonstrate satisfactory performance at the upgraded tier may have their probation period extended or they may be downgraded to the lower tier for which they were previously approved.

- A. It has long been common practice for Lenders to use consultants, individuals and companies, to increase market share. The term consultant, as used here, applies to a mortgage broker, loan correspondent and packager.

Under Traditional Application Processing (TAP) and Multifamily Accelerated Processing (MAP), the role a consultant may play in processing a loan is different. This difference has led to some confusion on the part of MAP Lenders and HUD Field Staff. The roles and relationships a consultant may or may not have under TAP and MAP processes are the following: -

1. Under TAP, the consultant refers new business to a Lender including information supplied by a proposed mortgagor/sponsor.
 - a. The consultant may provide a wide range of additional services to the Lender. Field Offices may accept application packages, correspond with and rely on information submitted by the consultant on behalf of the Lender.
 - b. The consultant's fee is paid from the mortgagee's fees.
 - c. The consultant cannot have any identity of interest with the mortgagor, sponsor or affiliated entity. HUD may permit an exception to the rule if:
 - (1) The consultant's regular business is brokering and processing loans; and
 - (2) The relationship is fully disclosed to and approved by HUD before an application for mortgage insurance is submitted to HUD.
2. Under MAP, the consultant's sole purpose is to represent the interest of the proposed mortgagor/sponsor including providing information on their behalf to the MAP Lender. In this regard the consultant's fee is not considered a broker's referral fee.
 - a. The consultant's fee is paid from the mortgagee's fees.
 - b. The consultant cannot have any identity of interest with the mortgagor/sponsor or affiliated entity.
 - c. There is no additional role for the consultant. HUD only accepts application packages from, corresponds with and relies on information submitted by an approved MAP Lender. HUD staff only deals with employees of the MAP Lender and documents signed by the MAP Lender. In their applications for approval MAP Lenders submitted information on employees authorized to sign for them. MAP Lenders are authorized to hire third party contractors for appraisal, architecture and cost. The underwriter performs the mortgage credit function and must be a full time employee. The third party contractors cannot have any identity of interest with the mortgagor/sponsor or affiliated entity.

- d. This should not be interpreted to mean that an approved MAP Lender can't underwrite a transaction and sell it to another MAP Lender before initial endorsement. See Chapter 1, Section 1.3.

2.12**Inactivity and Disciplinary Actions**

- A. Lenders and underwriters will be considered inactive at the time of the lender's annual certification to LQMD, if they have not submitted a pre-application within the preceding two calendar years. Inactive lenders and underwriters will be terminated from the MAP program, must reapply for approval and must meet the same criteria as would a new lender or underwriter.
- B. Designated MAP chief underwriters will be considered active even if they have not personally underwritten and submitted a MAP pre-application or application within the preceding 5 calendar years.

CHAPTER 3

SUMMARY OF MAJOR CHANGES IN CHAPTER 3 OF THE MAP GUIDE

Eligible Multifamily Mortgage Insurance Programs

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 3 revisions in the new release:

- Sections 3.9 - added Section 231 Housing for the Elderly as an eligible MAP program.
- Sections 3.5, 3.6 - clarifies policy for services and meals in elderly projects.
- New occupancy requirements for Section 223(f). Risk mitigation?
- Section 3.5.D, 3.6.C, 3.8.K - Underwriting ratios for the debt service coverage Sections 221(d), 223(f).
- Section 3.5.D, 3.6.C, 3.8.K - Underwriting parameters for the maximum mortgage limitations, Section 221(d), 223(f).
- The removal of Section 232 Residential Care Facilities as an eligible MAP program.

Chapter 3

**Eligible Multifamily Mortgage
Insurance Programs**

3.1**Introduction**

This chapter contains the basic program requirements for the HUD/FHA multifamily mortgage insurance programs for which MAP Lenders can submit pre-applications and Firm Commitment applications. Other multifamily mortgage insurance programs such as Section 241 Supplementary Financing for Insured Project Mortgages are eligible under TAP processing and where local Hub and Program Centers offer fast track processing of this program.

3.2**General**

The following requirements or program features apply to *all* HUD mortgage insurance programs:

- A. Regulatory Agreement. All mortgagors must execute a HUD regulatory agreement governing the operation of the project. The regulatory agreement will be recorded at initial endorsement.
- Single Asset Entity. The mortgaged property must be the only asset of the mortgagor (borrower) and there may not be more than one mortgagor. It is important that the Department maintain the single-asset requirement. If any form of ownership is proposed which would dilute the single-asset requirement, the Director, Office of Multifamily Development, must first approve it before a field office can accept any application for mortgage insurance.

In order to preserve the Department's single asset requirement, there may not be more than one mortgagor

- C. Non-recourse. The HUD mortgage note may contain a non-recourse provision, if the Lender agrees.
- D. Fixed interest rate. The interest rate on a HUD insured loan is negotiated between the mortgagor and mortgagee and must be fixed for the term of the mortgage. The interest rate is fixed at initial endorsement for Insurance of Advances cases and at the start of construction for Insurance upon Completion cases. For mortgage increases, a higher or lower rate may be fixed for the *increase only*.
- E. Amortization plan. All HUD insured mortgages must be amortized through a level annuity monthly payment plan (LAMP), which requires equal monthly payments of principal and interest. LAMP variations are permissible for transactions involving bond financing and/or tax abatement.

- F. HUD application fee. The FHA application fee is \$3 per \$1,000 (30 basis points) of the mortgage amount. Market rate pre-applications must pay a non-refundable 15 basis point review fee, which fee will be credited to the 30 basis point Firm Commitment fee if an invitation letter is issued and a Firm Commitment application is submitted. Affordable housing transactions (as defined in Section 3.2.R below) that submit for two stage processing must pay the 30 basis point fee at the Firm Commitment stage, but will not be charged a fee for pre-application review.
- G. HUD inspection fee. The HUD inspection fee is \$5 per thousand of the mortgage amount for new construction and \$5 per thousand of improvement costs for substantial rehabilitation. The inspection fee for loans insured pursuant to Section 207/223(f) is:
1. \$30 per unit where the repairs are \$3,000 or less per unit
 2. \$30 per unit on projects with no repairs
 3. 1% of the cost of repairs where repairs are more than \$3,000 per unit. The minimum threshold for the inspection fee is \$30 per unit.
- H. HUD mortgage insurance premium. The HUD construction and annual mortgage insurance premiums are based on a percentage of the mortgage amount and may vary, depending on the type of project mortgage. The initial premium is payable in advance at initial endorsement/loan closing.
- I. Mortgagee fees and charges. The maximum financing fee the Lender may charge is 3.5% of the mortgage amount. (Higher fees up to 5.5% are permissible in bond transactions, for all MAP eligible programs. See Chapter 8 for details.) MAP Lenders can include Third Party costs as a mortgageable soft cost in the mortgage calculations. Include Third Party costs, i.e., appraisal, market study, PCNA, with other Organization Costs, if any, in Section G., line 65 of Form HUD 92264. Third Party costs are included in the calculation of BSPRA where it is applicable.

The MAP Lender's Third Party Costs, reflected in Organization Costs are exempted from the 65% initial endorsement disbursement rule. The rule only applies to the mortgagor's organizational costs.

- J. Fair Housing and Equal Opportunity. Mortgagors and all contractors and subcontractors must comply with all HUD Fair Housing and Equal Opportunity requirements, including selection of occupants, employment, physical and programmatic accessibility (See 24 CFR Part 100 and subsequent sections), and "Affirmative Fair Housing Marketing" (24 CFR Part 200.600 and Handbook 8025.1 Revision 2).

For projects being refinanced under Section 223(f) that contain violations of the design and construction requirements of the Fair Housing Act, the Fair Housing Act violations must be corrected as a condition of mortgage insurance. If a project built after March 13, 1991, is submitted for refinance or purchase under Section 223(f) and inspection reveals that it does not meet all of the design and construction requirements of the Fair Housing Act, the project must be retrofitted to meet these requirements as a condition of mortgage insurance. These structural modifications/retrofits must meet the following conditions:

1. Retrofits/corrections of Fair Housing Act violations may be either Critical or Non-Critical Repairs, depending on whether the violations pose a direct threat to life and safety. For discussion and examples, see Appendix 5C.E.
2. The modifications/retrofits may commence after Initial/Final closing, but must be completed no later than one year after the Initial/Final closing date.
3. Public and common areas: Except in extraordinary circumstances, modifications/retrofits of the public and common areas of the project must commence within thirty days after the Initial/Final closing date.
4. Residential Units:
 - a. Modifications/retrofits for individual units in the project must be scheduled to commence within sixty days after the Initial/Final closing date.
 - b. Advance notice to residents. Immediately after the issuance of the Firm Commitment, residents must receive written notification indicating the modifications/retrofits to be performed, the anticipated start date and work schedule, and, if necessary, the schedule of temporary relocation for each unit.
 - c. Work schedule. When estimating the cost of construction items that will require temporary relocation of residents, the Needs Assessor must develop a work schedule for these items that will efficiently utilize labor crews and provide for smooth turnover of temporary accommodations for each resident in turn.
 - d. Relocation costs. In the process of developing a scope of work for repairs and modifications/retrofits, the Needs Assessor must consider whether the proposed work will require the temporary relocation of residents while certain work items are being done. If temporary relocation is determined to be necessary, the Needs Assessor, using the work schedule, must estimate a relocation schedule and an overall relocation time, and develop a separate cost estimate for relocation to appropriate housing. The estimated relocation costs should be listed separately from the construction repair and modification/retrofit costs when developing the cost estimate for “critical” and “non-critical” repairs and Fair Housing Act compliance-related modifications/retrofits.
5. In all cases, once these structural modifications/retrofits are begun, the work should be completed without unreasonable delay. All structural modifications/retrofits must be completed within one year after the Initial/Final Closing date.
6. All such modifications/retrofits must conform to the escrow and inspection requirements contained in Chapter 12, Section 12.17.
7. The extent and cost of the modifications/retrofits will determine whether the project is feasible as a 223(f) or whether to resubmit it as substantial rehabilitation.

- 8.** In no case may the Department insure such a project without a modification/retrofit plan.
- K. Previous Participation.** All principals in the proposed transaction must submit detailed information either via the electronic Active Partner Participation System (APPS), or on Form HUD-2530 regarding previous participation in governmental housing transactions in order to be approved by HUD for participation in any program of mortgage insurance.
- L. Occupancy.** Except in the case of a project specifically designed exclusively for the elderly (age 62 and over), the mortgagor must certify that it will not discriminate against families with children.
- M.** HUD's Fiscal Procedures are contained in HUD Handbook 4410.1 Revision 2.
- N. Bridge or Gap Financing.** This is generally defined as, a loan spanning the gap between the termination of a short-term loan and the start of another long-term loan and is permitted as long as any recent indebtedness placed against the project was not in an effort to increase the mortgage or circumvent outstanding policy.
- O. Transient Housing/Hotel Services Prohibition.** Section 513 of the National Housing Act prohibits the use of the mortgage insurance programs for transient or hotel purposes. Leases for less than 30 days are prohibited. The mortgagor cannot execute leases for less than 30 days nor provide occupants with hotel services such as maid service, furnishing and laundering of linens, room service and bellboys.
- P. Operating Deficit.** The operating deficit is required on all applications for new construction and substantial rehabilitation. The operating deficit escrow provides funding for operating expenses and debt service when net income is not available during the initial lease up period. These escrows are not mortgageable and unused portions are returned to the Borrower. The appraiser will calculate the number of months for an operating deficit and the estimated amount for that period of time, according to outstanding guidance. The underwriter analyzes the appraiser's estimate and may adjust it if appropriate.

There is no increase in the operating deficit escrow requirements described in the MAP Guide for substantial rehabilitation projects with at least 90% project based rental assistance. For low income tax credit projects with a funded operating deficit reserve held by the partnership (even though controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the increased reserve requirements. The FHA controlled accounts must still meet the current operating deficit requirements as described in the exiting guidance.

For market rate new construction, and for substantial rehabilitation projects in which there will be significant tenant displacement resulting in negative cash flow during the rehabilitation period, operating deficit escrows will be the greater of:

1. What the appraisal and underwriting analysis determines to be appropriate, or
2. Three percent (3%) of the mortgage amount, or

3. Four (4) months debt service (Principal, Interest and Mortgage Insurance Premium) if the property is garden apartments, or six (6) months debt service (Principal & Interest and Mortgage Insurance Premium) if the property is an elevator building where a single Certificate of Occupancy must be issued before any of the units or any of the entire floors can be rented.

HUD will consider Lender requests for Initial Operating Deficit draws during lease-up. Lender requests must be accompanied by: a) a review and analysis of the monthly accounting reports detailing progress on lease up as compared to the lease up projections used in underwriting, and b) an updated calculation of the sufficiency of the escrow. This analysis and calculation is particularly important if the project is experiencing substantial variations from its lease up projections. Unused amounts will be released upon the Lender's request at the later of 12 months after final endorsement or when the project has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy. For garden apartment projects consisting of separate buildings, each of which is leased up separately, HUD will consider partial releases of the operating deficit escrow as individual buildings achieve 6 months of break-even occupancy. The Lender is responsible for insuring funds are released solely for project operating needs. Again, the FHA controlled accounts must still meet the current operating deficit requirements as described in the exiting guidance.

- Q. Working Capital Escrow. The Working Capital Escrow requirement for new construction transactions will be 4% of the mortgage amount, half of which will be a construction contingency for cost overruns and change orders. *A separate section to the working capital escrow will govern the 2% construction contingency.* The construction contingency portion of the escrow will be refunded to the developer at final endorsement if not used. Change orders funded from the contingency portion of the working capital escrow will not be considered as the basis of a request for increased mortgage amount.

There is no increase in the working capital escrow requirements for substantial rehabilitation projects with at least 90% project based rental assistance. For low income housing tax credit projects with a funded working capital reserve held by the partnership (even though controlled by the investor and not by HUD or the lender), the funded reserve will be credited towards the increased reserve requirement, although the FHA controlled account must still meet the current working capital escrow requirements as described in existing guidance.

As is the case with operating deficit escrows, these funds are not mortgageable and the unused portion will be returned to the borrower if not needed. The working capital portion of the escrow will be released upon the Lender's request at the later of 12 months after final endorsement or when the project has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy.

- R. Definition of Affordable Housing.
 - a. For purposes of applying the affordable housing underwriting standards and program requirements, affordable will be defined as: (a) projects that have a recorded regulatory agreement in effect for at least 15 years after final endorsement, (b) projects that meet at least the minimum Low Income Housing Tax Credit (LIHTC) restrictions of 20% of units at 50% of

area median income (AMI), or 40% of units at 60% of AMI, with economic rents (i.e. the portion paid by the tenants) on those units no greater than rents on those units no greater than LIHTC rents, and (c) mixed income projects if the minimum low income unit rent and occupancy restrictions and regulatory agreement meet the above criteria.

- b. Projects need not use LIHTCs to qualify for affordable underwriting so long as they have, and are in compliance with, a recorded regulatory agreement imposing the minimum low income occupancy and restricted rent tests in (a), above, and having a term of at least 15 years after final endorsement.

S. Furnished Rental Units.

Furnished rental units may be allowing in application underwriting (for all programs or just 221d???) . The furnished units may not be recognized in the underwriting of the net operating income or expenses to arrive at an insured mortgage. No extra income than the replacement and maintenance has to increase. The furnished rental rent/income is limited to ten percent (10%), which is common in the industry. The underwriting is to unfurnished unit rent rather than the premium rent and the rent/income must be separately stated. Higher expenses for replacement and maintenance are expected??? The underwriting will record the income on the line XX Other Income on HUD Form 92264(???)

When other income gets bumped up (elevated) for extra income generated from corporate/furnished premium units, the Lender will need to explain in the underwriter's narrative and document in the underwriting when the five percent (5%) is exceeded. The differences between furnished and unfurnished unit rent is that the premium income from the furnished unit is underwritten as other income.

3.2.1

Maximum Mortgage Amounts

A criterion of the maximum mortgage that the Department may insure is the statutory per family unit limit, Criterion 4a on Form HUD-92264-A (see Chapter 8, Section 8.7 and Appendix 8B). Per family unit limits may be increased by the following means:

- A.** High Cost Percentage (HCP) increases. On an annual basis, all jurisdictions are assigned a geographic HCP multiplier. The maximum geographic HCP multiplier is 240 percent times the statutory per family unit base limit. On a case-by-case basis, jurisdictions may exceed the assigned HCP. The maximum case-by-case HCP multiplier for jurisdictions that are not High Cost areas is 240 percent times the statutory per family unit base limit.
- B.** High Cost Areas.

4. The threshold for a High Cost area is an assigned HCP multiplier of 175 percent or greater.
 5. The maximum assigned HCP multiplier for High Cost areas is 240 percent. On a case-by-case basis, High Cost areas may exceed the assigned HCP. The maximum case-by-case HCP multiplier for High Cost areas is 270 percent times the statutory per family unit base limit.
- C. Alaska, Guam, Hawaii, and the Virgin Islands. The maximum HCP multiplier for these areas is 50 percent greater than the geographic maximum HCP. This results in a maximum HCP multiplier of 360 percent times the statutory per family unit base limit.

3.3**New Construction/ Substantial Rehabilitation
Multifamily Rental Apartments: Eligible Programs –
Sections 220, 221(d)(3), and 221(d)(4) and 231**

MAP Lenders can submit requests for pre-application review and Firm Commitment applications for the following programs;

- Section 220: private or public
- Section 221(d)(3): nonprofit mortgagor only
- Section 221(d)(4): general
- Section 231: general or nonprofit
- Section 207: general

3.4**New Construction/Substantial Rehabilitation
Multifamily Rental Apartments: Requirements and
Program Features**

- A. HUD can insure loans for 5 or more residential units with complete kitchens and baths for both the construction and permanent loan (called Insurance of Advances) or just the permanent loan (called Insurance Upon Completion).
- B. New Construction: generally, proposed construction of improvements where no work has been done to the site prior to the initial endorsement of the loan.
 1. Work can begin after issuance of a HUD Firm Commitment with specific approval case-by-case from the HUD Field Office using the Early Construction Start process. See Chapter 5, Section 5.7.
 2. Construction may not start on Insurance Upon Completion projects until issuance of a Firm Commitment.

- C. **Substantial Rehabilitation:** a property qualifies as substantial rehabilitation if it meets one of the following criteria:
1. The cost of repairs, replacements and improvements exceeds the *greater* of 15% of the estimated replacement cost after completion of all repairs, replacements, and improvements, or \$6500 per unit adjusted by the local HUD Field Office high cost percentage for that area, *or*
 2. Two or more major building components are being substantially replaced. Additions are permitted in substantial rehabilitation projects, but the costs for the additions of new units (not building component additions) are *not* included in the eligibility test.
- D. **Mortgage Term.** The maximum term is 40 years or 75 % of the remaining economic life of the property; whichever is less. (See Chapter 8, Section 8.5)
- E. **Prepayment Restrictions.** HUD permits prepayment restrictions in connection with the financing.
- F. **Cost Certification.** The mortgagor is required to submit a cost certification prepared by an independent public accountant upon completion of construction or substantial rehabilitation. The amount of mortgage that is finally endorsed for insurance by HUD after completion of construction can be reduced based upon HUD review of the cost certified amounts. The general contractor is also required to submit a cost certification if there is an identity of interest with the mortgagor. Identities of interest subcontractors are also required to cost certify.
- G. **Federal Labor Standards.** The general contractor and any subcontractors are required to comply with federal wage and reporting requirements, including the payment of prevailing wage rates and the submission of weekly certified payroll reports (Prevailing wage schedules may be obtained from the HUD Field Office).
- H. **Liens/Secondary Financing.** The National Housing Act requires HUD insured mortgages to be first liens. Secondary liens are permissible in the case of other HUD insured second mortgages (supplemental loans and operating loss loans) and other loans. (See Chapter 8 for complete details on secondary financing.)
- I. **Commercial Space.** Commercial facilities adequate to serve the needs of the project's occupants may be included. Commercial space is limited to 10% of the gross floor area of the project and commercial income is limited to 15% of gross income (higher percentages are permissible under section 220; see Section 3.7).
- J. **Military Impacted Areas.** HUD is prohibited from providing mortgage insurance in military impacted areas unless HUD determines that demand from nonmilitary households is sufficient to sustain occupancy in both the HUD-insured projects and the market as a whole. Section 238(c) of the National Housing Act authorizes insurance in military impacted areas upon certain findings by the Department of Defense (DOD) and HUD Headquarters. Section 238(c) loans are not eligible for MAP review. In such areas, mortgagors should be encouraged to contact the Department of Defense for other potential programs administered by DOD, which could provide other sources of financing for the proposed projects. Such projects can also be reviewed using the traditional HUD mortgage insurance review process under Section 238(c).

- K. Student Housing.** Projects financed with insured mortgages cannot be designed for student occupancy (e.g., 4 bedroom units with 4 baths.) Students and families are eligible occupants for family housing financed with mortgage insurance. However, project mortgages in college areas must be underwritten at comparable rents for family housing in the area. Loans cannot be underwritten with rental rates assuming multiple student occupants that would result in a processing rent higher than a typical family apartment.
- L. Real Estate Requirements.** The HUD insured mortgage must be on real estate;
1. held in fee simple, or
 2. under a lease for not less than 99 years which is renewable beyond that; or
 3. under a lease having a period of not less than 10 years to run from the maturity date of the mortgage.
- M. Assurance of Completion.** The mortgagor shall provide for assurance of completion of the project in forms approved by HUD.
1. For non-elevator or three stories or less elevator buildings where the cost of construction or rehabilitation is more than \$500,000, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD's estimate of construction or rehabilitation cost including an imposed builder's profit on BSPRA transactions. As an option, HUD would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 15% of the HUD estimate of construction or rehabilitation cost.
 2. For elevator buildings of 4 stories or more, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD's estimate of construction or rehabilitation cost including an imposed builder's profit on BSPRA transactions. As an option, HUD would accept a completion assurance agreement secured by a cash deposit or Letter of Credit in the amount of 25% of HUD's estimate of construction or rehabilitation cost.
- N. Market Study.** For all new construction and substantial rehabilitation projects with significant tenant displacement, the appraisal and market study should be completed by different firms. This requirement includes LIHTC transactions with economic rents, which do not have project based rental assistance. The Hub Director can waive this requirement on a case-by-case basis, if it is clear the appraiser or appraisal firm is capable of performing both the appraisal analysis and a macro-economic market analysis, and if the strength of the market is not in question. Market studies are not required for properties with at least 90% of units covered by a rental assistance contract and no rent increase.

In addition to the general requirements in Sections 3.2, 3.3, and 3.4, the following requirements apply to Sections 221(d)(4) and Section 231 (new construction only) projects:

- A. **Builder and Sponsor's Profit and Risk Allowance (BSPRA).** The BSPRA allowance is used as a credit against the mortgagor's required equity contribution. To use BSPRA, there must be an identity of interest between the mortgagor and general contractor. There is no builder profit contained in the mortgage calculation. For new construction, BSPRA is 10% of the estimated cost of on site improvements; structures; general requirements; general overhead; architect's fees; carrying charges and financing; legal, organizational and audit expenses (total of lines 50, 63 and 67), exclusive of land. For substantial rehabilitation, BSPRA is no more than 10% of the above costs exclusive of the as is value of the existing structure.
- B. **Sponsor's Profit and Risk Allowance (SPRA).** An amount included in replacement cost where no identity of interest exists between the general contractor and mortgagor. SPRA is no more than 10% of the total estimated cost of: architect's fees, carrying and financing charges, legal, organizational, and audit expenses.
- C. **Elderly Developments.** Apartments specifically designed for the elderly (age 62 and over as defined by the National Housing Act) are permitted as long as they do not contain the mandatory meals and services, central kitchens and dining areas, and non-shelter spaces associated with retirement service centers. Non-shelter services shall not be made a mandatory condition of occupancy, or offered as an optional service. This includes, but is not limited to maid service, transportation service, infirmaries or clinics. These services shall not be included in the proposal or offered through or associated with the project. Non-shelter spaces already constructed for projects with current HUD-insured mortgages may include formal dining areas with meal services to be provided on an optional basis. All Cooperatives can provide modest kitchen equipment in a non-shelter space for the use of occupants or for catering services. The kitchen should be sufficient in size to support sanitary requirements. Additioan requirements related to the provision of meals are as follows:
 - 1. Any meal service must be provided on an optional basis.
 - 2. The cost of meals may not be included in the residents' rental charges.
 - 3. The costs associated with the operation of the meals service are the responsibility of the entity that operates the optional meal service.
 - 4. The mortgagor may receive payment from the operator of the meals service. In such cases, this revenue may not be included in the underwriting of the project, as this service is optional for each resident, thereby potentially producing a revenue stream that is both unpredictable and unreliable.
 - 5. A determination should be made by the Lender that the expenses associated with a third party meal provider will not increase the project risk.

6. Any meal service must be operated by a meal provider licensed under state or local law and in compliance with current health and safety requirements for food service providers.
7. Local HUD Counsel must determine that the granting or revocation of any licensing required to operate a proposed meal service will not jeopardize the ability of the project to operate as rental housing in accordance with the requirements of HUD's Regulatory Agreement.
8. Costs associated with developing a facility insured under section 223(f) to include a meal service may be considered in the mortgage, subject to outstanding requirements limiting non-shelter space and commercial areas.

D. Maximum mortgage limitations. In general, the maximum insurable mortgage is limited to the lesser of:

1. For Section 221(d)(4): The *applicable percentage* of the HUD estimated replacement cost (new construction) or the *applicable percentage* of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation).
 - a. 90% for projects with 90 percent or greater project based rental assistance;
 - b. 87% for projects with tax credits; or
 - c. 83.3% for projects that is market rate.
2. For Section 231: 90% of the HUD estimated replacement cost (new construction) or 90% of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation).
3. Statutory per unit limitations, adjusted by the Field Office high cost percentage. (See Chapter 8 for complete details.)
4. A mortgage amount supported by debt service coverage ratio (DSCR):
 - a. For Section 221(d)(4) projects with:
 1. 90 percent or greater project based rental assistance compute a DSCR of 1.11 (90% of net income);
 2. Tax credits a DSCR of 1.15 (87% of net income); or
 3. Market rate a DSCR of 1.20 (83.3% of net income).
 - b. For Section 231 a DSCR of 1.11 (90% of net income).

3.6

Section 221(d)(3) and Section 231 (new construction only) for nonprofit

In addition to the general requirements in Sections 3.2, 3.3, and 3.4, the following requirements apply to Section 221(d)(3) and Section 231 (new construction only):

- A. Nonprofit sponsor/mortgagors only. MAP review of Section 221(d)(3) and Section 231 insured loans is limited to nonprofit mortgagors, **defined** as corporations or associations organized for purposes other than profit or gain for itself or persons identified therewith and which HUD finds is in no way controlled by or under the direction or persons or firms seeking to derive profit or gain there from. Generally, it is required that mortgagors be chartered under Chapter 501(c)(3) of the Internal Revenue Code. HUD will review in detail the relationships between the nonprofit sponsor/mortgagor and profit-motivated entities involved in the transaction. HUD will not insure Section 221(d)(3) and Section 231 transactions unless the nonprofit has the financial capacity and experience to own and operate the project successfully and is not under the direction or control of the profit motivated entities involved.
- B. Elderly Developments. Apartments specifically designed for the elderly (age 62 and over as defined by the National Housing Act) are permitted as long as they do not contain the mandatory meals and services, central kitchens and dining areas, and non-shelter spaces associated with retirement service centers. Non-shelter services shall not be made a mandatory condition of occupancy, or offered as an optional service. This includes, but is not limited to maid service, transportation service, infirmaries or clinics. These services shall not be included in the proposal or offered through or associated with the project. Institutional central kitchens are not permitted, however this prohibition does not preclude the installation of a kitchen sufficient in size to support sanitary requirements in a non-shelter space associated with the provision of catered meals. Other requirements applicable to the provision of meals in proposed Section 231 projects are:
1. Any meal service must be provided on an optional basis
 2. The cost of meals may not be included in the residents' rental charges.
 3. The costs associated with the operation of the meals service are the responsibility of the entity that operates the optional meal service.
 4. The mortgagor may receive payment from the operator of the meals service. In such cases, this revenue may not be included in the underwriting of the project, as this service is optional for each resident, thereby potentially producing a revenue stream that is both unpredictable and unreliable.
 5. A determination should be made by the Lender that the expenses associated with a third party meal provider will not increase the project risk.
 6. Any meal service must be operated by a meal provider licensed under state or local law and in compliance with current health and safety requirements for food service providers.
 7. Local HUD Counsel must determine that the granting or revocation of any licensing required to operate a proposed meal service will not jeopardize the ability of the project to operate as rental housing in accordance with the requirements of HUD's Regulatory Agreement
 8. Costs associated with developing a Section 231 project to include a meal service may be considered in the mortgage, subject to outstanding requirements limiting non-shelter space and commercial areas.

For existing elderly housing projects desiring to add optional meals but requiring modifications in non-shelter space to accommodate such service, a second mortgage under Section 241(a) mortgage insurance may be considered.

C. Maximum mortgage limitations. In general, the HUD maximum insurable mortgage is limited to *the lesser of*:

1. For Section 221(d)(3) projects:
 - a. 90% of the HUD estimated replacement cost (new construction) or 90% of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation) for projects with 90 percent or greater project based rental assistance; or
 - b. 95% of the HUD estimated replacement cost (new construction) or 95% of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation) for affordable transactions.
2. For Section 231 - 100% of the HUD estimated replacement cost (new construction) or 100% of the sum of the HUD estimated cost of repair and rehabilitation and the as is value of the property (substantial rehabilitation).
3. Statutory per unit limitations, adjusted by the Field Office high cost percentage. (See Chapter 8 for complete details.)
4. A mortgage amount supported by debt service coverage ratio (DSCR):
 - a. For Section 221(d)(3) a DSCR of 1.11 (90% of net income).
 - b. For Section 231 a DSCR of 1.05 (95% of net income).

D. Prepayments. A Section 221(d)(3) and a Section 231 mortgage with a nonprofit borrower cannot be prepaid in full without the prior approval of HUD.

3.7

Section 220

In addition to the general requirements in Sections 3.2, 3.3, and 3.4, the following requirements apply to Section 220:

- A. Eligible areas.** The property must be located in one of the following:
1. Existing slum clearance and urban redevelopment projects covered by a Federal aid contract before the effective date of the Housing Act of 1954.
 2. An approved urban renewal area under Title I of the Housing Act of 1949.
 3. Disaster urban renewal projects assisted under Section III of the Housing Act of 1949 as amended.
 4. An area of concentrated code enforcement being carried out under Section 117 of the Housing Act of 1949.

5. A concentrated development area, approved by the HUD Field Office, in which concentrated housing, physical development and public service activities are being carried out in a coordinated manner, pursuant to a locally developed strategy for neighborhood improvement, conservation or preservation. The locally developed strategy shall:
 - a. Provide for a combination of physical improvements, necessary public facilities and services, housing programs, private investment and citizen self-help activities appropriate to the needs of the area.
 - b. Coordinate public and private development efforts;
 - c. Provide sufficient resources to produce substantial long-term improvements in the area within a reasonable amount of time, taking into account the severity of the area's problems.
- B. Commercial Facilities. Commercial space may be included which is intended to serve the needs of the project residents and other residents of the area. Commercial space is limited to 20% of gross project area and commercial income to 30% of gross income. Section 220 projects underwritten to the maximum commercial space or commercial income allowed by the program must be underwritten to market rate standards even if all or some of the housing units are affordable. Section 220 projects with both commercial space and commercial income less than the maximum allowed in the program can be treated as affordable so long as they meet the definition in Chapter 3 Section 3.2.R above.
- C. Maximum mortgage limitations. In general, the HUD maximum insurable mortgage is limited to *the lesser of*:
 1. 90% of HUD estimated replacement cost (new construction) and 90% of the sum of the HUD estimated cost of repairs and rehabilitation and the as is value of the property (substantial rehabilitation).
 2. A mortgage amount supported by 1.1 debt service coverage (90% of net income).
 3. Statutory per unit limits, adjusted by the Field Office high cost percentage. (See Chapter 8 for complete details).
- D. Builder/Sponsor Profit and Risk Allowance (BSPRA). See definition of BSPRA in Section 3.5 above.
- E. Sponsor Profit and Risk Allowance (SPRA). See definition of SPRA in Section 3.5 above.
- F. Elderly Developments. Apartments specifically designed for the elderly and/or limited to elderly occupancy are not permitted under this section.

3.8**Section 223(f) Acquisition/Refinancing of Existing Apartments**

In addition to the general requirements in Section 3.2, the following requirements apply to Section 223(f) when used for acquisition or refinancing: 1) Any property acquired before the date of the mortgage insurance application shall be treated as a

refinance transaction. 2) Any property acquired after the date of the mortgage insurance application shall be treated as a purchase. 3) In a purchase transaction, any identity of interest, however slight, between seller and purchaser requires the application to be processed as a refinance. 4) Where the mortgage insurance application is part purchase and part refinance, you must treat it as two separate transactions and add the controlling mortgages together; the application is not treated simply as a purchase or refinance transaction.

A. Eligible Properties.

1. The property must contain at least 5 residential units with complete kitchens and baths, and have been completed or substantially rehabilitated for at least 3 years before the date of application for mortgage insurance. Properties that were constructed or substantially rehabilitated with HUD-insured multifamily mortgages and the latent defects guarantee period has expired, these properties are exempt from the 3-year rule. Projects with additions completed less than 3 years previous are eligible as long as the addition is not larger than the original project in size and in number of units
2. Condominiums. A project which was built and intended as condominiums, but is now operating as a rental project, may be considered under Section 223(f) if the condominium regime is converted to a single owner with no individual unit ownership, and the property meets the other program guidelines, including the minimum occupancy standards.

Condominium ownership regimes and plots may be recorded if the property is otherwise operated as a rental project with a single ownership entity owning all the apartments. Separate condominium units may be established for commercial use and for housing use which must include all the residential apartments. The FHA insured loan must be secured by a mortgage on the rental apartment portion and any mortgageable commercial space. Joint use and maintenance agreements and easements between the FHA insured portion and any separately demised condominium portion must be defined.

The Multifamily Hub Director may consider a waiver for a condominiumized building with a limited number of individually owned units if all the owned units are located in a separate building or in a separate section of a single building apart from the rental units. HUD will not consider a waiver if any ownership units are interspersed with the rental units.

B. Ineligible properties.

Properties whose required repairs are so extensive that they meet the threshold for substantial rehabilitation are not eligible under this Section.

C. Repairs.

1. Critical repairs must be performed prior to HUD endorsement of the mortgage.
2. Non-critical repairs, approved by HUD, may be completed after endorsement with appropriate financial escrows at closing.

3. Properties with Fair Housing Act violations. Any property available for first occupancy after March 13, 1991, containing violations of Fair Housing Act accessibility design standards must, as a condition of mortgage insurance, be modified/retrofitted to bring it into compliance with Fair Housing Act accessibility design standards. The modifications/retrofits may be completed after endorsement with appropriate financial escrows at closing, and must be done in accordance with instructions in Section 3.2 J and Chapter 5, Section 5.24.
 4. Required repairs cannot be so extensive as to constitute substantial rehabilitation.
- D. Elderly developments. Refer to the requirements contained in 3.5.C.
- E. Prior Defaults/Claims. HUD does not prohibit applications for mortgage insurance for formerly HUD-held loans. However, HUD is not obligated to accept or process any mortgage insurance application with a borrower/principal who has not proven to be a good business partner. MAP Lenders should accept such applications only after they have considered and documented the economic, physical, operational, or management factors that led to the specific changes that have occurred which would justify new mortgage insurance. Early consultation with the field staff is strongly recommended since HUD will be very concerned with past experience of the loan and borrower/principal including Regulatory Agreement compliance.
- F. Labor standards. Davis Bacon prevailing wage requirements do not apply to this program.
- G. Insurance Upon Completion Only. HUD will insure only the permanent loan under this program.
- H. Prepayment Provisions and Prohibition. The National Housing Act prohibits prepayment of loans insured under Section 223(f) for 5 years from the date of endorsement for insurance except where at the time of prepayment:
1. The mortgagor has entered into an agreement with HUD to maintain the property as rental housing for the remainder of the specified 5 year term;
 2. HUD has determined that the conversion of the property to cooperative or condominium ownership is sponsored by a bona fide tenants organization representing the majority of households in the project;
 3. HUD has determined that continuation of the property as rental housing is unnecessary to assure adequate rental housing for low and moderate income people in the community; or
 4. HUD has determined that continuation of the property, as rental housing would have an undesirable and deleterious effect on the community.
- I. Eligible Mortgagors treated as General Mortgagors. Both profit motivated and nonprofit borrowers are eligible mortgagors.
- J. Ineligible Mortgagors. Condominium and Cooperative mortgagors are not eligible for MAP processing procedures.
- K. Maximum mortgage limitations. In general the maximum mortgage limitations for the Section 223(f) program are as follows:

1. For a purchase transaction, *the lesser of*:
 - a. HUD appraised value is either:
 - (1) 87% for projects with 90 percent or greater project based rental assistance, or
 - (2) 85% for affordable projects, or
 - (3) 83.3% for market rate projects.
 - b. Section 207 statutory per unit limits, adjusted by the local Field Office high cost percentage for the locality, or
 - c. A mortgage amount supported by a debt service coverage ratio (DSCR) on projects with:
 - (1) 90 percent or greater project based rental assistance is 1.15 (87% of net income), or
 - (2) Affordable units the rate is 1.1765 (85% of net income), or
 - (3) Market units the rate is 1.20 (83.3% of net income).
 - d. Percent of cost of acquisition is either:
 - (1) 87% for projects with 90 percent or greater project based rental assistance, or
 - (2) 85% for affordable projects, or
 - (3) 83.3% for market rate projects.
2. For a refinance transaction, *the lesser of*:
 - a. HUD appraised value is either:
 - (1) 87% for projects with 90 percent or greater project based rental assistance, or
 - (2) 85% for affordable projects, or
 - (3) 83.3% for market rate projects.
 - b. Section 207 statutory per unit limits, adjusted by the local Field Office high cost percentage for the locality.
 - c. A mortgage amount supported by a debt service coverage ratio (DSCR) on projects with:
 - (1) 90 percent or greater project based rental assistance is 1.15 (87% of net income), or
 - (2) An affordable rate is 1.176 (85.% of net income), or
 - (3) A market rate is 1.20 (83.3% of net income).
 - d. The greater of the cost to refinance or 80% of the HUD appraised value.

NOTE: Fifty percent (50%) of any cash out proceeds after funding transaction costs, including the assurance of completion requirements, must be held in escrow by the Mortgagee until the required non-critical repairs are completed and HUD approves the release.

(See Chapter 8 for complete details.)

- L. Reserve for Replacements. HUD requires deposits to the Reserve for Replacements. (See Chapter 7 for the actual calculations.)

- M. Secondary financing. HUD permits secondary financing on section 223(f) loans under certain conditions. (See Chapter 8 for complete details.)
- N. Commercial space. Commercial area shall not exceed 20% of the total net rentable area of the project and commercial income shall not exceed 20% of effective gross income.
- O. Real estate requirements. The mortgage shall be on real estate held:
1. in fee simple; or
 2. under a lease for not less than 99 years which is renewable; or
 3. under a lease executed by a lessor approved by HUD with a minimum term of 50 years from the date the mortgage is executed.
- P. Mortgage Term. The maximum term of the mortgage is: 35 years or 75 % of the remaining economic life of the property, whichever is less. (See Chapter 8, Section 8.5 and 24 CFR 200.82)
- Q. Firm Commitment Processing Only. There is no pre-application submission for Section 223(f) applications. Preliminary inquiries with the HUD staff are encouraged if there are concerns about marketability, environment or competing proposals.
- R. Occupancy Standards. Projects must have an average physical occupancy rate of at least 85%. For market rate properties, the maximum underwritten physical occupancy rate is 93%. For affordable properties, the maximum underwritten physical occupancy is 95% if a property has: a) at least 90% of units covered by a rental assistance contract, or b) affordable rent restrictions on 100% of units with all unit rents at least 20% below comparable market rents.
- Projects must demonstrate a pattern of stable occupancy, i.e. the average occupancy standards noted above, for a period of six months prior to submission of the Firm Commitment application, and maintain that occupancy through to the date of Initial/Final Endorsement. Continued occupancy consistent with the underwriting conclusions must be documented with an updated rent roll no more than 30 days prior to closing. The following special condition will be added to Firm Commitments:
- The borrower must submit an updated, certified rent roll detailing the occupancy level at the project. The rent roll must be dated no more than 30 days prior to endorsement. If HUD determines that the updated rent roll shows a significant change in occupancy from that submitted at the time of application and that was assumed in the loan approval, then this Commitment shall be of no force or effect and will be cancelled by HUD.*
- S. Market Study. Section 223(f) proposals typically do not require a market study separate from that contained in the appraisal, however in volatile or declining markets, the Lender should consider and may be required to obtain such a study to support the underwriting conclusions of market demand for the subject property over the loan term. Multifamily Program Center staff should consult with Economic Market Analysis Division (EMAD) in such cases. Market studies are not required for properties with at least 90% of units covered by a rental assistance contract and no rent increase.

3.9

Section 231 Housing for the Elderly and/or Handicapped

- A. Nature and Purpose. Mortgage insurance under Section 231 of the National Housing Act provides a program for relieving the shortage of housing for elderly and/or handicapped persons. A project shall comprise eight or more new or rehabilitated units designed for use and occupancy by elderly persons and handicapped persons.
1. The program will involve the following types of mortgagors:
 - a. Public
 - b. Public Non-Profit Organizations
 - c. Private Non-Profit Organizations
 - d. Private Profit-Motivated Organizations
 2. Section 231 projects sponsored by private nonprofit mortgagors are eligible for participation in the rent supplement program. Up to five percent of the total contract authority authorized in appropriation acts may be used in Section 231 and Section 202 senior citizens and/or handicapped projects. Current regulations permit up to 100 percent of the units in a Section 231 project to be occupied by families in the rent supplement program, but administratively, an increase over the limits established will be permitted only on a case-by-case basis. Participating projects shall meet the maximum gross monthly rentals established by HUD for the program.
 3. Nonprofit mortgagor. A nonprofit mortgagor is a corporation or association organized for purposes other than profit or gain for itself or persons identified therewith that HUD finds is no way controlled by or under the direction of persons or firms seeking to derive profit or gain there from. Generally, such a mortgagor must be chartered under Chapter 501(c)(3) of the Internal Revenue Code. A Headquarters review is required on all Section 231 nonprofit Map and TAP firm commitment processing before the issuance of the firm commitment. See Section 3.6 for documents to be submitted by Hubs/Program Centers to the Office of Multifamily Development for review.
 4. Definitions/Explanations of Terms:
 - a. Elderly Person. A person 62 or older.
 - b. Handicapped Person. A person who has a physical impairment which,
 - (1) is expected to be of a long-continued and indefinite duration;
 - (2) substantially impedes his/her ability to live independently; and

- (3) is of such a nature that his/her ability to live independently could be improved by more suitable housing conditions.
- c. **Occupancy Preference.** Sponsoring nonprofit organizations such as labor unions, professional groups, and fraternal or civic organizations, may give preference to their members, provided membership in the organization is open without regard to race, color, national origin, sex, disability or religion. However, sponsors cannot restrict occupancy to their members.
- (1) **Founder's Fees and Prohibition.** "Founders' Fees," "admission fees," or similar types of payments are prohibited in connection with a Section 231 proposal.
- B. **Determining the Market.** Because of the many factors involved in the determination of market for a housing project for the elderly, it is required for all new proposals to have a third party market study. Experience has clearly shown that letters of interest from people residing in other localities are an unreliable indication of the market for a project for the elderly, even in areas traditionally considered attractive to retired people. The marketability of a proposed project should, therefore, be judged on the basis of demand expected to be generated primarily within the market area where the project is to be located. Also note that no project should be approved unless it merits at least minimum related facilities. Otherwise the project would be an ordinary multifamily housing project and should not be processed under Section 231.
- C. **Room Composition, Design and Special Amenities.** Particular attention is to be given to room composition to assure it is consistent with the needs of the elderly market. All units must be designed for use and occupancy by elderly or handicapped persons. In projects of sufficient units to support them, auxiliary facilities such as a lounge, infirmary facilities or multipurpose rooms are to be encouraged to the extent consistent with the needs of the occupants. The auxiliary facilities must be considered in processing in accordance with outstanding underwriting guidelines and administrative instructions.
- D. **Calculation of Maximum Insurable Mortgage.** Directions for the calculation for the maximum insurable mortgage for Section 231 loans can be found in Chapter 8, Section 8.7.

3.10**The Mortgagee of Record**

Nothing described herein can be construed as relieving the MAP Lender of its requirement to enforce all of HUD's insurance requirements. *Only HUD Headquarters may waive the requirements.*

3.11**Updated and Additional Property Insurance Requirements**

A. Insurance during Construction.

1. Public Liability Insurance on a Commercial General Liability form with limits of not less than \$500,000 per occurrence to protect the Owner during the construction phase from claims involving bodily injury and/or death and damage to the property of others. Such Commercial General Liability Insurance shall be endorsed to include owners' and contractors' protective coverage.
2. Vehicle Liability Insurance with limits of not less than \$300,000 for one person and \$500,000 for more than one person to protect the Owners for claims for bodily injury and/or death, and not less than \$100,000 against claims for damage to property of others arising from the owner's operation of vehicles. Such insurance shall include coverage for employer's owned, non-owned and/or hired vehicles, where applicable.

B. Permanent Insurance

Upon acceptance of the project, or any portion thereof from the contractor, the owner shall provide a certified duplicate copy of the following insurance coverage. In some instances, continuation of the insurance obtained for the construction period, with proper endorsements thereto, will be acceptable. In any event, the Owner shall assure that there is no gap period in insurance protection during the transition from the Insurance During Construction to the Permanent Insurance.

1. Public Liability Insurance on a Commercial General Liability form with limits of not less than \$500,000 per occurrence protect to the Owner from claims involving bodily injury and/or death and property damage which may arise from the Owner's operations, including any use or occupancy of its facilities, grounds and structures, and shall include independent contractors coverage, where applicable.
2. Vehicle Liability Insurance. If the Owner owns or a vehicle in the operation of the project, including non-owned and/or hired vehicles operated for the benefit of the Owner, the Owner shall procure and maintain Vehicle Liability Insurance. Such insurance shall provide for limits of liability of not less than \$300,000 for one person and \$500,000 for more than one person to protect the owner from claims for bodily injury and/or death, and not less than \$100,000 against claims for damage to property of others.

CHAPTER 4

SUMMARY OF MAJOR CHANGES IN CHAPTER 4 OF THE MAP GUIDE Application Requirements

This Memorandum is intended to help reviewers of the accompanying Chapter 4 Application Requirements of the MAP Guide understand which major issues have been addressed in the revision.

This Memo will not be published as part of the Guide. There is a major highlights section included in the MAP Guide that directs/advises Field Office personnel and MAP Lenders as to the specific changes made to the guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (**4425.2 Rev. 2, Basic Underwriting**; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagees and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgage Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 4 revisions in the new release:

- Section 4.1 B - Added the option of combining the preapplication and firm stage of processing into one.
- Section 4.2 D – Authorization to the Field Office to approve up to three 30 day extensions for the submission of the application for a Firm Commitment in response to the letter of invitation.
- Section 4.2.A & 4.2.C – Risk Mitigation underwriting Improvements, concept meeting, preapproval of mortgagees with \$250M in asset and two stage processing.

Application Requirements

4.1

Introduction

- A. Only an approved MAP Lender may submit an application for mortgage insurance using MAP. As a reminder, the HUD office processing an application must review the qualifications and approve the Lender's staff underwriter previously approved by HUD Headquarters. The Lender's appraiser and its architecture/engineering and construction cost reviewer(s), whether on contract or on staff, must also be approved.
- B. There is a two-stage process for new construction and substantial rehabilitation under the Sections 221(d)(3) and 221(d)(4), and 220 programs, however Lenders have the option of either going through two stages or **opting to combine both into the Firm commitment phase of processing**. When opting for two stages processing, first, the Lender submits exhibits for a pre-application review by HUD. After review, HUD either rejects the application or invites the Lender to submit an application for Firm Commitment. The second stage is the submission of the Lender's exhibits for the Firm Commitment. After review of the application for Firm Commitment, HUD decides whether or not to issue a Firm Commitment.

When a MAP Lender opts to go straight to Firm Commitment, they must address and include all of the exhibits previously required at pre-application with the exhibits required for Firm Commitment processing, and perform all of the responsibilities for Pre-application and Firm Commitment processing. Also, when proceeding straight to Firm Commitment, an application fee is required and will be considered earned in accordance with outstanding instructions governing fee and premium charges.

- C. For acquisition or refinance of an apartment project under Section 223(f), the Lender goes straight to the application for a Firm Commitment. No pre-application review is required or anticipated.
- D. The Site Appraisal and Market Analysis (SAMA) stage and the Conditional Commitment stage will not be used under MAP. If an applicant seeks a Conditional Commitment for Section 223(f) mortgage insurance where the purchaser has not yet been identified, the loan application must be processed using TAP.
- E. The submission of computerized forms generated by a Lender is acceptable, so long as the recreated form has the Office Management and Budget (OMB) number, expiration date, form title, form number, is identical in content and in the order of the line items on the MAP Form. The recreated form must be completed subject to the instructions included on that form in the MAP Forms Book.

4.2**Stages of Application****A. Informal Information**

Hubs and Program Centers welcome inquiries from MAP Lenders. Each Hub or Program Center which serves as a processing center for multifamily mortgage loan insurance has designated a Hub MAP Coordinator to respond to inquiries about potential applications. For example, if a Lender is considering a loan application, it may inquire whether there are other mortgage loan applications in the same area in process and under review by the Hub or Program Center. It may inquire about environmental concerns in the area, to the extent that HUD knows of such concerns. The Lender may clarify information about the MAP process. The Hub or Program Center, in responding to informal inquiries, will not commit HUD to approve a market, issue an invitation for an application for firm commitment, or make any commitment of any kind. Approval or disapproval of an application for FHA mortgage insurance is accomplished only in the manner set forth in this Guide, and not in response to informal inquiries. The Hub MAP Coordinator website is found at www.hud.gov/offices/hsg/mfh/map/coordinates.cfm.

1. New Project Concept Meetings

All Section 220, 221(d)(3), 221(d)(4), and 231 projects (both market rate and affordable) must participate in a concept meeting with the Hub or Program Center. The Hub MAP Coordinator will schedule either in person or by teleconference a concept meeting where the project has an early review before submitting a pre-application or direct to Firm Commitment application. Concept meetings are not required, but are strongly encouraged for Section 223(f) transactions. The submissions required from the Lender for a concept meeting review should address the following items, to the extent possible at this preliminary stage.

a. New Construction/Substantial Rehabilitation Proposals:

- Section of the Act
- Number of market rate and affordable units
- Projected mortgage amount
- Basic information on developer and principals
- Management company
- General contractor
- Previous HUD experience
- Geographic location with map
- Photographs of the subject and immediate surroundings
- Site improvements (existing/proposed)
- Commercial component – discuss potential tenants
- Amenities
- Community / city / state support
- Green / sustainability Issues

- Development status (e.g., have any permits/approvals been obtained?)
 - Discuss general market conditions, competitive properties and comparables
 - Environmental issues
 - Potential risks and mitigating factors
 - Any anticipated waiver requests
- b. Refinancing or Acquisition Proposals:
- Section of the Act
 - Number of market rate and affordable units
 - Projected mortgage amount
 - Mortgage term and estimated remaining economic life
 - Refinance or acquisition
 - Basic information on developer and principals
 - Management company
 - Previous HUD experience
 - Geographic location with map
 - Photographs of the subject and immediate surroundings
 - Actual and effective property age / class
 - Physical condition
 - Prior / proposed renovations (per unit cost)
 - Discuss eligibility for Section 223(f) versus substantial rehabilitation
 - Amenities
 - Existing debt / cash out
 - Current occupancy (physical / economic)
 - Income and expenses
 - Discuss green / sustainability issues as appropriate
 - Discuss general market conditions, competitive properties and comparables
 - Environmental issues
 - Actual / potential risks and mitigating factors
 - Any anticipated waiver requests

The Lender should complete form HUD-92013, “Application for a Multifamily Housing Project” to the extent possible.

Where practicable, site visits by the appropriate HUD staff are encouraged. HUD will respond in writing (either by e-mail or more formally) within 5 working days of the concept meeting/site visit. Depending on the completeness and quality of the submission, HUD may recommend or not recommend that the Lender make an application, or they may request additional information or specify conditions or recommendations for the Lender and sponsor to consider. Consideration should be given to the effect on other FHA-insured projects in the subject’s market area that are already in the pipeline, developer experience and overall feasibility based on the exhibits and information presented.

2. Pre-Approval. As you prepare for the concept meeting, plan to inquire about and pay particular attention and additional scrutiny on cases where principals have greater than \$250,000,000 of outstanding FHA insured debt. Advise the MAP Lender that as part of their financial analysis of a principal(s) with this situation their review of the principals' Schedule of Real Estate Owned and Schedule of Mortgage Debt must identify principals that exceed this \$250,000,000 threshold. Lenders will need HUD pre-approval before such principal or Borrower may apply for additional insurance commitments. The MAP Lender must submit in writing an analysis that separately explains a principals' status of FHA insured debt, conclusions of the analysis and a recommendation on the risk of each principal proposed for mortgage insurance. The Lender must submit the analysis on letterhead to the Hub MAP Coordinator where the project will be reviewed. The cover letter shall state their request for pre-approval of the analysis by HUD Headquarters. The Hub MAP Coordinator will submit the package to HUD Headquarters for pre-approval. If prepared, the Lender can present the written analysis at the concept meeting. If there are no revisions to the analysis as a result of the concept meeting discussions, the Hub MAP Coordinator will forward the package to HUD Headquarters for pre-approval. If at some point before the {pre-application or invitation to firm commitment is sent by HUD?) is received by HUD processing office and any of the principal(s) have changed, any new principal found to have \$250M in insurance debt must go through the pre-approval process before the {pre-application can be receive or invitation to firm commitment letter is sent.

B. Approval of Lender's Reviewers

1. The Lender's reviewers for the pre-application or the application for Firm Commitment must be approved by the field office processing the application. For the pre-application, the Lender must submit the name and experience of the underwriter (who must be employed full-time by the Lender), and the name and the experience of the Lender's appraiser, and of the market analyst (if separate from the appraiser). If a Hub has previously approved a member of the Lender's staff or a contractor, the Lender is required only to submit the names of the staff or contractor and note the prior approval. For the application for Firm Commitment, the Lender must submit the names and experience of the staff underwriter and the Lender's appraiser (if not previously submitted), and of the reviewer or reviewers of the architectural and engineering plans and specifications, and the construction cost estimator. HUD will approve or disapprove these persons promptly. If HUD does not advise the Lender within ten working days that an underwriter, appraiser, or reviewer is unacceptable, giving the reasons for its decision, the person is approved. The Lender should submit the names and resumes, if possible, prior to the pre-application and, for applications going directly to Firm Commitment, prior to preparation of the application.

C. Pre-application. The pre-application stage for new construction or substantial rehabilitation is designed to permit HUD to review the most important exhibits affecting the feasibility of a proposed project. At the end of the review, HUD invites the Lender to submit an application for a Firm Commitment or declines to issue an invitation. The Lender who receives an invitation has reason to believe that, if its application for a Firm Commitment is consistent with the information

it presented at the pre-application, there is a high likelihood that HUD will issue a Firm Commitment.

1. No application fee is required for affordable housing (as defined in Chapter 3 Section 3.2.R above) pre-applications that submit two stage processing for review by HUD. Borrowers must pay the 30 basis point fee with the submission of the Firm Commitment application. Market rate pre-applications must pay a non-refundable 15 basis point review fee, which will be credited to the 30 basis point Firm Commitment fee if an invitation letter is issued and a Firm Commitment application is submitted. The HUD processing office (Hub or Program Center) may request clarifying information if it believes such information is essential to the review.
2. Preliminary appraisal work which includes a narrative rental and expense analysis with the submission of Forms HUD 92274, 92273 and the 92264-T, if applicable and an estimate of land value for new construction projects (or “as is” value for substantial rehabilitation project) by comparable analysis, are required. The complete appraisal with a cost approach may be submitted with the application for Firm Commitment.
3. The Lender’s assessment and preliminary evaluation of the sponsor’s creditworthiness, is required. To the extent the mortgagor entity and principals have been identified at this stage, initial information about the sponsor’s experience, including a brief summary of mortgage credit qualifications and schedule of real estate owned and maturing debt should be provided with the pre-application.
4. Two Stage Processing. Market rate Section 220, 221(d), and 231 applications must be submitted under two stage processing (i.e., including a pre-application submittal) and may not apply directly for a Firm Commitment. The Hub Director may waive two stage processing and allow a direct to Firm Commitment application for a stable, occupied market rate substantial rehabilitation property that, during the rehabilitation period, will not have: a) major rehabilitation or unit reconfiguration, b) tenant displacement except for short periods during interior rehabilitation of a unit, c) a reduction in current occupancy levels, d) negative cash flow, or e) for properties in stable markets for which a pre-application Letter of Invitation recently expired on a substantially unchanged proposal. Affordable properties (as defined at Chapter 3 Section 3.2.R), or those with 90% or more rental assistance, may submit a Section 221(d) (4) application directly for Firm Commitment.

D. Letter of Invitation

1. After the pre-application review, the Hub or Program Center will send a letter to the Lender inviting an application for a Firm Commitment or declining to invite the Lender to submit the application. The letter may also address issues related to project acceptability and it may suggest proposed project underwriting parameters.
2. If the letter is an invitation to submit an application, the Lender must advise HUD in writing within 30 calendar days of the date of the letter of invitation whether or not it plans to submit an application for the particular project. If it fails to notify HUD within the time required, the invitation letter expires, and it may be required to repeat the pre-application process.

3. The application for a Firm Commitment must be submitted within 120 days of the date of the letter of invitation. The Hub or Program Center Director may authorize **three** 30-day extensions of this 120-day limit, but there is no requirement that the extensions be approved. The Hub or Program Center Director will review the circumstances reported by the Lender to justify the extension of time. The Lender must certify in writing and the Hub or Program Center Director must determine that the requested delay beyond 120 days is not likely to change the underwriting data on which the invitation was based or to undermine the feasibility of the project due to a change in the market or other factors determined at pre-application. **In the rare circumstance where there is a justifiable request by the Lender for an extension of time beyond the 90-days that the Hub or Program Center Director may allow, the Hub or Program Center Director must request authorization to approve a further extension from the Director of the Office of Multifamily Development or his/her designee. The authorization request must provide the additional time requested, the Hub or Program Center's recommendation, and the reasons the extension is needed. It may be sent and responded to by e-mail.**

E. The Application for a Firm Commitment

1. After receiving an invitation to submit an application for a Firm Commitment, the Lender completes the processing of the application. It performs a full underwriting analysis and presents its recommendation in the Narrative Summary to HUD. The exhibits that accompany the application are listed in Section 4.3. HUD's review of these exhibits is discussed in Chapter 11 "Underwriting" and in each of the technical chapters.
2. Applications which the Hub or Program Center determines to be unacceptable will be returned to the Lender and HUD may retain the application fee for the work done by HUD in its review. However, if the Hub or Program Center determines that the defects in the application are minor and can be corrected, the Hub or Program Center will advise the Lender. The Lender will have five business days from the receipt of notification to cure the application. HUD will not resume the review process until an acceptable application has been received.

NOTE: Where both the pre-application and firm commitment stages are applicable under MAP for a given FHA insured program, separate pre-application and firm commitment submissions are required as repeated throughout the Guide. Combining these applications into one submission is now permitted under MAP as an option. MAP is designed to assure timely decision-making on FHA insurance applications and to ensure an acceptable level of risk for HUD's multifamily mortgage insurance programs. MAP reviews at the pre-application and firm commitment stages must be meaningful and thorough. To support this goal, processing time frames have been established for MAP as provided in the Guide. MAP Lenders have a stated number of days within which to submit a firm commitment application following FHA's letter of invitation. If the allotted time is not needed to prepare a complete firm application there is no prohibition against a much earlier submission that should expedite the overall process.

4.3

Applications Checklist

- A. Each of the chapters in the MAP Guide describes forms and other reports that the Lender must submit, either as part of the pre-application or as part of the application for a Firm Commitment. Those chapters provide the detail that is needed when submitting the required exhibits. For example, the checklist calls for a Narrative Summary; Chapter 11 “Underwriting” describes what information should be in the Narrative Summary and what sort of certification should accompany it.
- B. The appendices to this chapter are simply checklists of the exhibits that have to be provided to the Hub or Program Center. With new construction or substantial rehabilitation, the exhibits are divided into two parts: (1) exhibits required for the pre-application review, and (2) the exhibits required for the application for a Firm Commitment. With Section 223(f) for refinancing or purchase, there is no pre-application review, so the exhibits are required for the application for a Firm Commitment.
- C. Lenders must submit an original and one (1) hard copy of the underwriting file, exhibits and third party reports and must submit an electronic version of these materials on a disc or a removable drive to the HUD processing office.
1. Appendix 4.A
 - Sections 220, 221(d)(3) and 221(d)(4), New Construction and Substantial Rehabilitation, Exhibits Required for Pre-Application Review
 - Sections 220, 221(d)(3) and 221(d)(4), New Construction and Substantial Rehabilitation, Exhibits Required for Application for Firm Commitment
 2. Appendix 4.B
 - Section 223(f) for Refinance or Purchase of Existing Apartments, Exhibits Required for Application for Firm Commitment.

CHAPTER 5

SUMMARY OF MAJOR CHANGES IN CHAPTER 5 OF THE MAP GUIDE Architectural Analysis

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, **4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance**, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Chapter 5 specific revisions in the new release:

- Section 5.1 - Added the Needs Assessor as the preparer of the Project Capital Needs Assessment (PCNA) for acquisition/refinance projects pursuant to Section 223(f).
- Section 5.2 – Amended to include the requirement of professional liability insurance for the Design Architect, the Architect administering the construction contract and all engineers and or designers providing required design and/or construction services.
- Section 5.7 – Added firm commitment through initial endorsement – new construction is the requirement for the MAP Lender to sign and initial the plans and specifications. They are also required to maintain a complete set of drawings.

- Also added in this Section, is guidance and instructions on when and how to approve Early Construction Starts. Specifically outlining the mandatory condition under which an Early Start can be approved:
- Firm Commitment – there must be a valid outstanding Firm commitment, including;
 - Site control and the right to legally access the site for purposes of construction.
 - HUD-approved set of contract drawings and specification on file with the department.
 - Required construction contract and other construction documents, including, but not limited to:
 - o Construction contract, form HUD-92442 or HUD-92442-A
 - o Supplementary conditions of the contract for construction, form HUD-2554
 - o Applicable Davis-Bacon wage decision (supplied by HUD Labor Relations)
 - o Assurance of completion for On-site and Off-site improvements.
- The HUB Director is required to document the file, fully defining the rationale and compelling reason for granting an early start after determining that an immediate closing is not practical, there is reasonable evidence and assurance that closing will occur in the near future; there is a compelling need to start construction before the anticipated closing date; an early start of construction will not be detrimental to HUD’s interest. It is also stated in this section that Form FHA-2415 must be complete and that HUD has no insurance obligation or liability whatsoever for costs incurred during an early start if the project does not reach endorsement.
- Section 5.17 - added provisions regarding the hiring of a qualified LBP and/or asbestos abatement contract if a project is determined to have either of these conditions.
- Section 5.24 expands instructions on the Fair Housing Act Accessibility considerations on structural modifications/retrofits for Section 223(f) projects.
- Sections 5.28 thru 5.38 previously contained instructions on Section 232 applications, because this program has been transferred to the Office of Insured Health Care, all reference were deleted.

Chapter 5

Architectural Analysis

5.1

Qualifications, Responsibilities, and Approval of Lender's Representative

A. Qualifications

1. Architectural Analysts and Needs Assessors:
 - a. Architectural Analyst: The Lender shall hire a qualified architectural analyst(s) with experience in multifamily construction. The analyst must be knowledgeable and experienced with local building standards and construction methods for the type of project proposed, including the Federal Fair Housing Accessibility Guidelines. The Architectural analyst may also serve as the cost estimator if the qualifications are met.
 - b. Needs Assessor: The Lender shall hire a qualified Needs Assessor to prepare the Project Capital Needs Assessment (PCNA) for acquisition/ refinance projects pursuant to Section 223(f). See Appendix 5H for a description of the Needs Assessor's qualifications and responsibilities.
2. Lender Architectural staff. The lender must be able to review all designs submitted. The lender must employ the services of a qualified architectural reviewer or contract for the services of a qualified reviewer, to review the architectural plans and specifications. The person providing the architectural services should be preferably a registered architect or engineer. However, persons with a degree in architecture or engineering with three years of experience in their respective field may also provide this service. Additionally, individuals with experience as a construction manager, estimator, general superintendent of construction, draftsman, degree in building construction, may also qualify to provide architectural services.
3. Lender Technical Specialists. Mechanical, structural, sanitary, site engineers, etc. may be required for review of a particular project. The prime principal of the technical specialists must be a licensed professional. The architectural analyst is not required to review structural design details and calculations.

B. Responsibilities

The Lender's architectural analyst:

1. Reviews mortgagor's Required Architectural Services. (See Section 5.2)

2. Determines that the project design complies with the Minimum Property Standards, local codes, the applicable accessibility requirements, and HUD design standards. (See Appendix 5)
3. Determines that mortgagor's Architect (or other persons or organizations providing architectural services) is qualified to provide the design services to the project and administer the construction contract.
4. Reviews mortgagor's Architect's certification that the project design complies with the Minimum Property Standards, all applicable local codes and ordinances, Fair Housing Act accessibility requirements, and HUD standards. (See Appendix 5I)
5. Determines that the mortgagor's Architect's liability insurance will be maintained up through acceptance of the 12-month warranty inspection.

C. HUD Approval of Lender's Architectural Analyst and Needs Assessor:

The Department reserves the right to examine the credentials of all architectural analysts and Needs Assessors hired by the Lender, and to reject any and all individuals that it considers unqualified.

5.2

Required Architectural Services for Design and Supervision

The mortgagor shall engage a licensed professional for the design of elevator and walkup projects, projects of 20 or more living units, and smaller projects of complex design or construction.

- A. Licensing and Insurance. Design and construction professionals must be licensed and must carry liability insurance.
1. Professional License. Architects, engineers and/or designers providing required design and/or construction services must be professionally licensed to render services in the design of buildings by the State in which the project is to be constructed.
 2. Professional Liability Insurance.
 - a. The Design Architect, the Architect administering the construction contract, and all engineers and/or designers providing required design and/or construction services must each be covered by a policy of professional liability insurance in an amount consistent with insurance industry practice.
 - b. For each MAP project, the professional liability insurance policy must be maintained up through acceptance of the 12-month warranty inspection.
 - c. At initial closing, there shall be provided for each Architect and other design and/or construction professional, the writing agent's certificate of liability insurance. The certificate must substantially conform to the sample Certificate of Professional Liability Insurance contained in Appendix 5I.1

- B. Evaluation and Selection of Architect. The Architect must be one in whom the mortgagor, Lender, and HUD have confidence.
1. The Lender's architectural analyst
 - a. Reviews the Architect's work progress and product(s);
 - b. May recommend that the mortgagor select another professional if the Architect's work progress or work product(s) is found to be unacceptable.
 2. Failure of the mortgagor to engage an Architect acceptable to the Lender is basis for rejection of the project.
- C. Owner-Architect Agreement. On projects requiring licensed professional service, an agreement between the Architect and the owner for architectural services will be executed.
1. The owner shall submit the agreement with the application for Firm Commitment.
 2. The executed agreement shall be AIA Document B 108, Standard Form of Agreement Between Owner and Architect for a Federally Funded or Federally Insured Project. It shall include the HUD Amendment.
 - a. The scope of services shall provide all architectural, structural, mechanical, electrical, civil, landscape, and interior design and consulting services necessary to prepare drawings, specifications and other documents setting forth in detail the requirements for construction of the project. The scope of services shall also provide for administration of the construction contract.
 - b. The scope of services shall designate the responsibility for the services to be provided, whether by the Architect, owner, or others.
 - c. Additional B108Agreements must be submitted for any part of the basic design services with more than one prime professional, e.g. for site, civil, mechanical, electrical engineering services, etc., or supervisory architectural services. The mortgagor's Architect shall have the authority to coordinate multiple prime professional contracts.
 3. There may be separate agreements for design and construction services if the same Architect is not employed. When there is a separate agreement for administration of the construction contract, it must be submitted not later than initial endorsement. Where separate agreements are made, those sections not applicable shall be struck out.
 4. An Architect with an identity of interest with the owner or general contractor cannot administer the construction contract. An identity of interest is defined in the HUD Amendment.
- D. Modification of Owner-Architect Agreement. The document may be changed to reflect the actual agreement between owner and Architect for the specific project.
1. Generally modifications can be made by striking out inapplicable provisions and inserting additional provisions in Article 12. Also, adding directly to a specific provision is acceptable.
 2. Changes shall not delete any service, either by the Architect or owner necessary to the project though the responsibility for a required service may be transferred.

- a. The document shall provide a clear and definite statement of how responsibility for providing any required service is to be divided between Architect, owner, and others. Documents must conform to requirements in Section 5.2.C.2 above.
- b. Required services may not be sublet or delegated to any one not acceptable to HUD.
3. The basis of compensation (Architect's fee) shall be a fixed fee for the services provided by the Architect as stated in the Agreement. No other method of stating compensation is acceptable. The amount of compensation for design services and for construction services shall be stated.
4. Where the Architect's basic fee exceeds that which may be paid from mortgage proceeds or where the Owner-Architect Agreement provides for reimbursable expenses (note that reimbursable expenses may not be paid from mortgage proceeds), the person/entity responsible for such extra fees must be identified on the HUD Amendment.
5. HUD shall not be incorporated into any specific provision of the Agreement. The required inclusion of the HUD Amendment in Article 12 is sufficient to incorporate HUD requirements. No modification of the HUD Amendment is permitted.
6. The Lender's architectural analyst shall review the agreement for compliance with these instructions.

5.3

Architectural Standards and Other Criteria

- A. The principal architectural standards for MAP are the Minimum Property Standards for Housing (MPS) in HUD Handbook 4910.1 and local building codes or nationally recognized building codes accepted by the Hub. See Appendix 5 for complete standards.
- B. Accessibility for persons with disabilities.
 1. The Fair Housing Amendments Act of 1988 applies to all housing in the United States available for first occupancy after March 13, 1991. (See Appendix 5A.)
 1. Part 504 of the Rehabilitation Act of 1973, which is implemented by the Uniform Federal Accessibility Standards (UFAS), apply only to housing receiving Federal financial assistance. Part 504 does not apply to projects where the only HUD involvement consists of FHA mortgage insurance. (See Appendix 5A)
 2. The Minimum Property Standards includes the Uniform Federal Accessibility Standards (UFAS) in its requirements for Housing for the Elderly. The UFAS will apply in addition to other applicable accessibility standards to any housing for the elderly that is constructed or rehabilitated under Sections 221(d), and 231.
- C. Energy efficiency.
 1. New Construction. HUD energy efficiency standards for new construction are adopted by the Secretary and incorporated by reference into the MPS. (See Appendix 5A)
 2. Substantial Rehabilitation. See Appendix 5B, paragraph I for rehabilitation energy guidelines.

5.4**Architectural Processing – New Construction****A. Lender's Architectural Analyst's Duties**

1. Review the mortgagor's Architectural/Engineering exhibits (Appendix 5E) for compliance with local code and HUD requirements.
 - a. Drawings and specifications must be complete and correct.
 - b. Acceptable evidence must be provided that the project has or will have necessary utility services and pedestrian and vehicular access.
 - (1) Adequate assurance of continuing service by local utility companies and/or local public authorities, or
 - (2) Construction documents and contract for completion by mortgagor's contractor.
2. Visit the site and prepare a written report on physical aspects of on-site and offsite features.
 - a. Observe physical features such as existing construction, topography, soil conditions, drainage, vegetation, etc.
 - b. Include unusual site conditions and necessary demolition and offsite construction.
 - c. Determine and comment on HUD environmental conditions and criteria which may affect the proposal.
3. Provide for continuous architectural liaison with the mortgagor's Architect.
4. Maintain a processing record of all architectural/engineering actions when the proposal is first assigned.
 - a. File all forms, reports, decisions, and documents relevant to architectural actions in chronological order.
 - b. Record all architectural actions, counteractions by others, or actions that may affect design or construction.
 - c. Record the receipt of forms and documents, the issuance of letters and memoranda, the completion of forms and worksheets, contacts with the Architect, etc.
 - d. Log and briefly describe contacts, including telephone calls, with the Architect.
 - e. Keep journal of architectural actions. Include:
 - (1) Application for Firm Commitment, Form HUD-92013.
 - (2) Reports of site visit (including technical specialists' if made).
 - (3) Drawings and specifications identified and dated. (If filed elsewhere, reference in journal)
 - (4) Owner-Architect Agreement, including HUD Amendment. (See Forms Appendix)

- (5) Data used to process. (If filed elsewhere, reference in journal)
 - (6) Liaison meetings and telephone calls with Architect (Remarks in journal or notes).
 - (7) Letters, memoranda, notes and worksheets.
 - (8) Soil borings report or other soil exploration data.
 - (9) Invitation Letter.
 - (10) Form HUD-92264 with any memorandum for Firm Commitment.
 - (11) Firm Commitment approval.
 - (12) Surveyor's Report, Form HUD-2457 (Initial Endorsement).
5. Guide and assist the mortgagor's Architect during design development to expedite orderly processing and avoid delays.
- a. Assure that the Architect is licensed to practice within the State where the project is to be constructed.
 - b. Assure that the Architect and the mortgagor execute AIA Document B108, including HUD Amendment.
 - c. Provide the Architect a copy of the MAP Guide, applicable HUD program Handbook(s), HUD Minimum Property Standards (MPS) (Handbook 4910.1), and other applicable guides and publications, including reference material for all applicable accessibility laws, especially the Fair Housing Act Design Manual.
 - d. Discuss with Architect:
 - (1) Lender procedures;
 - (2) HUD procedures;
 - (3) Architects responsibilities.
 - e. Discuss with Architect any available housing design data and all HUD-developed or industry norms that are applicable and beneficial to the project.
 - f. Review drawings and specifications during design development and identify questionable design concepts, elements or deficiencies early to avoid costly revisions at advanced stages of exhibit development. Special attention should be paid to accessibility for persons with disabilities. Because no accessibility review is done at Pre-Application stage, it is entirely the responsibility of the Architect to produce a building and site design at Firm stage that fully conforms to all applicable accessibility laws._
6. Request assistance by the Technical Specialist, e.g., engineers, when necessary.
- a. Review and use the Technical Specialist's Report.
 - b. Furnish the Architect with consolidated design requirements, including recommendations or requirements of Technical Specialists.

7. Work with Lender's cost analyst to assure that project cost will fall within the established budget:
 - a. Supply cost analyst with a current Davis Bacon wage rate schedule. The HUD Office will include, as part of its Firm Commitment invitation letter, the current Davis Bacon wage rate schedule applicable to the proposed project. **Lender processing staff must keep in contact with HUD labor relations staff to obtain any updates (modifications) to the Davis Bacon wage rate schedule before the Lender submits the Firm Commitment application to HUD.** Once the Firm Commitment application is submitted, HUD labor relations staff will provide any Davis Bacon modifications which may be published and applicable to the construction of the project.
 - b. Evaluate appropriateness of type of structure, construction methods and materials considering initial costs and future maintenance.
8. Report any deviations from accepted concepts or HUD requirements which cannot be resolved with the mortgagor's Architect to the Lender's underwriter.
9. Be aware of design development progress in relation to established target dates and inform the Lender's underwriter of possible or actual delays or problems.
10. Review architectural/engineering exhibits submitted with the Firm Commitment application.
 - a. Assure exhibits are as agreed to during design development, meet conditions of the previous stage, and comply with all HUD standards and criteria.
 - b. Prepare the architectural/engineering portions of Form HUD-92264, Rental Housing Project Income Analysis and Appraisal (See MAP Forms Book), upon completion of architectural analysis.
11. Furnish information to the Lender's cost analyst as to the scope of the Architect's work as a basis for the estimation of the Architect's fee.
12. Assure that drawings and specifications are complete prior to submission of a Firm commitment application to HUD.
13. Review experience and qualifications of general contractor.
14. Prior to initial endorsement: (See Section 5.7)
 - a. Review contractor's Progress Schedule.
 - b. Review the legal survey and Surveyor's Report/ Certificate.
 - c. Assure that HUD's sets of drawings and specifications are sealed and signed.
15. Consult with Technical Specialists. While the Lender's architectural analyst should report obvious errors or omissions (such as a lack of dimension to show the depth of a footing below grade) to the mortgagor's Architect, the analyst is not required to review, nor is the analyst responsible for, the accuracy of structural dimensions or other details that would require a professional structural review. When engineering review, advice and guidance on specific projects or problems is required, the Lender's architectural analyst should request the services of the appropriate engineers (mechanical, structural, sanitary, site, etc.).

16. Negotiations.

- a. The Lender's architectural analyst provides guidance to the mortgagor's Architect. The Lender's analyst will request the assistance of the mortgagor if the Architect is reluctant to follow such guidance.

- (1) Suggestions for improvement or betterment should not be pursued if unacceptable to the mortgagor.

- (2) HUD mandatory standards and criteria may not be modified or waived.

- b. Report to the Lender's underwriter when resolution is not possible.

- (1) Recommend rejection only if the design fails to comply with prescribed requirements, laws, ordinances or restrictions, or is inadequate in some major respect.

- (2) Request intervention and assistance, describing the deficiency or inadequacy that the Architect and/or sponsor are unwilling or unable to correct.

B. Mortgagor's Architect's Duties

1. Services. Provides architectural and engineering services in accordance with the Owner-Architect Agreement. (See Section 5.2)
 - a. Develops documents that conform to concept of the sponsors program and proposal.
 - b. Produces drawings and specifications that comply with local requirements and HUD standards and criteria.
2. Data. The Architect's work is shaped by data such as: codes, transportation, parking, space and mechanical requirements. The Architect develops data through surveys and research.
3. Lender Assistance. There must be continuous consultation between the mortgagor's Architect and the Lender's architectural analyst.
4. Pre-application Stage. The Architect must:
 - a. Visit the site.
 - b. Evaluate the mortgagor's and user's needs.
 - c. Become familiar with applicable codes, restrictions, and requirements.
 - d. Develop preliminary sketches.
5. Firm Commitment Stage. The mortgagor's design Architect, from the preliminary sketches, must:
 - a. Prepare final construction documents after the basic exhibits are approved. These include contract drawings and specifications with:

- (1) Current wage decision,

- (2) Current edition of AIA Document A201, General Conditions of the Contract for Construction, and
 - (3) Form HUD-2554, Supplementary Conditions of the Contract for Construction.
- b. Submit the final construction documents to the mortgagor for approval and submission to the Lender, and to HUD.
6. Construction Documents must be complete and:
 - a. Clearly fix the scope of work.
 - b. Define and describe the materials to be used.
 - c. Illustrate the construction and methods of assembly.
 - d. Contain all necessary information for bidding (if applicable) and constructing the project.
 7. Alternates. The Architect may include alternates if they are of equal quality, safety, and performance, and within the budget. Alternates must be selected before a Firm Commitment is issued. Selection of alternates should be coordinated with the general contractor so as not to delay the bidding.

5.5

Architectural/Engineering Exhibits – New Construction

- A. Pre-application stage for HUD review. The mortgagor shall submit the following Pre-application exhibits to the Lender to be forwarded to HUD:
 1. Form HUD-92013, Application for Project Mortgage Insurance
 2. Location map with property clearly defined.
 3. Sketch plan of the site showing overall dimensions of main building(s), major site elements, (e.g. parking lots) and location of existing utilities, (e.g. water, sewer, electric, gas) in the streets adjacent to the site. Contour lines and elevations are not required in the sketch site plan.
 4. Sketch plans of main building(s): Sketch plans of main building(s) must show overall dimensions of:
 - a. Typical floor plan(s) showing apartment types and placement;
 - b. Ground floor plan(s) showing common areas;
 - c. Sketch floor plan(s) of typical dwelling unit(s);
 - d. Typical wall section(s) showing footing, foundation, and wall and floor structure. Notes must indicate basic materials in structure, floor and exterior finish.

Sketch plan dimensions must be sufficient to allow the HUD architectural analyst to calculate the Gross Floor Area for the entire project and the Net Rentable Areas for all the apartment units in the project.

- B. Firm Stage. The mortgagor shall submit the following Firm stage exhibits for the Lender's architectural analyst to review:
1. Form HUD-92013, Application for Project Mortgage Insurance.
 2. Owner-Architect Agreement, AIA Document B-108 (and HUD Amendment to the B108 where required), fully defining the services and fees for each prime professional with which the mortgagor/owner contracts directly. Additional contracts must be submitted for any part of the basic design services with more than one prime professional, e.g. for site, civil, mechanical, electrical engineering services, etc., or supervisory architectural services. The mortgagor's Architect shall have the authority to coordinate multiple prime professional contracts.
 3. Legal Survey. Note that the survey does not have to be new. An existing survey marked "Re-surveyed" and dated within the submission time frame is acceptable, provided that it is either done by the original surveyor or, if performed by a different surveyor, it must also contain the seal of the new licensed surveyor.
 4. Completed Surveyor's Report, Form HUD-2457, with responses to all questions;
NOTE: The American Land Title Association/American Congress on Surveying and Mapping (ALTA/ACSM) has its own mandatory certification language that differs in wording from HUD's mandatory certification language on Form HUD-2457. HUD's Office of General Counsel has found no legal conflict between the HUD and ALTA/ACSM certifications, and has no legal objection to the required ALTA/ACSM certification appearing on the survey map/plat along with the required HUD certification. Accordingly, both certifications may appear on the survey map/plat.
 5. Engineering and specialty reports, e.g. geotechnical, environmental, noise, flood hazard, toxic hazard, termite control, structural integrity (for Existing or Substantial Rehabilitation projects), heat gain/loss calculations, etc.
 6. Municipal and utility company letters of confirmation for the provision of services and/or offsite improvements.
 7. Any documents necessary to establish:
 - a. Site ingress and egress, utilities service and other general acceptability criteria in MPS 4910.1, Chapter 2.
 - b. Binding maintenance agreements where common use easements (e.g. driveways) are used.
 8. Certifications from mortgagor's Architect that:
 - a. Foundation designs reflect site soils limitations and design recommendations included in the foundation soils report and any other geotechnical reports (may be submitted by soils engineer);
 - b. All project structures, amenities, and site improvements are in full compliance with all applicable accessibility laws.
 9. Description of any identity of interest that exists between the prime professional providing supervisory architectural services, the owner, and the general contractor.
 10. Contract drawings and specifications. (See Appendix 5E)

11. Offsite Construction: Describe all work outside the boundaries of the property essential to the project. (See Appendix 5E)

5.6

Lender Deliverables – New Construction

- A. Pre-application Stage for HUD review. Mortgagor's architectural/engineering exhibits (See Section 5.5.A).
- B. Firm Stage.
 1. Mortgagor's Architectural/Engineering exhibits for Firm Stage (See Section 5.5B and Appendix 5E);
 2. Review Report prepared by Lender's architectural analyst. Report must state that all exhibits are acceptable without condition and all deficiencies have been acceptably corrected. Report should address the following:
 - a. Completeness of contract documents;
 - b. Conformance to local building codes and HUD Standards;
 - c. Accessibility for persons with disabilities:
 - (1) From property line to main entrance(s) to main building(s);
 - (2) To all areas throughout the project site;
 - (3) Within all residential structures:
 - (a) Path of travel to all public areas;
 - (b) Path of travel to all dwelling units required to be accessible under applicable accessibility laws;
 - (c) Within accessible dwelling units, full accessibility to all areas within, and full usability of all areas, including kitchens and bathrooms.
 - d. Site design:
 - (1) Placement of buildings, roads, walks and parking on the site;
 - (2) Site erosion and drainage;
 - (3) Soil borings report.
 - e. Building design:
 - (1) Building circulation:
 - (a) Adequacy of elevators;

- (b) Number and placement of stairs;
 - (c) Adequacy of lobbies and corridors;
 - (d) Adequacy of fire egress.
- (2) Typical dwelling units: Adequacy of room sizes and circulation within.
- (3) Fire safety: Provision of adequate fire safety measures, e.g. fire sprinklers, firewalls, fire doors (if required).
- (4) Structural adequacy: Review of building structure and structural details.
- (5) Mechanical and electrical adequacy: Review of mechanical and electrical plans.
- (6) Energy efficiency. Review utility combination for energy efficiency and determine acceptability of utility combination. If HUD has required a life cycle utility analysis to be included in the Firm Commitment application, see Section 5.8.B.1.b review utility analysis to determine acceptability of utility combination. See Appendix 5A, Paragraph O for energy efficiency standards.
3. Prepared architectural portion on Form HUD-92264, signed by Lender's architectural analyst under "Architectural Processor". When the project consists of more than one structure, the Lender must submit an itemized Gross Floor Area and Dwelling Unit Breakdown list, including unit count and unit areas, for each individual structure in the project.
4. Copies of Lender's architectural analyst's project files and logs only at the request of the HUD Office.
5. Standard certification by Lender's architectural analyst, see Chapter 11, Section 11.2.

5.7

Firm Commitment through Initial Endorsement – New Construction

- A. Changes after Firm Commitment. Prior to initial endorsement:
1. Drawings and specifications may be amended by addendum when the change(s) will have no effect on cost or value. The Lender's analyst must review the addenda for acceptability.
 - a. Addenda must clearly state or show the change with specific reference to the location of the item on the drawings or in the specifications.
 - b. Amendments shall be clearly noted and dated.

- c. Addenda are not to be used to correct errors noted during firm commitment processing.
 2. Firm Commitment reprocessing is required for major changes adding or deleting work, or affecting cost or value. Drawings and specifications affected must have sheets and pages revised and replaced.
- B. Contractor's Estimated Progress Schedule. Article 3.10.1 of the AIA General Conditions requires the general contractor to prepare and submit an "estimated progress schedule for the work" to the mortgagor and Architect.
1. The mortgagor or Architect must submit a copy to the Lender's analyst at least 30 days before initial endorsement.
 2. The Lender's analyst must review the Schedule to assure it relates to the entire project to the extent required by the contract documents. (Inclusive dates for stages of construction.)
Copies of the approved schedule are given to the HUD representative (HUD Inspector) to determine scheduled progress at each site visit.
 3. The Lender uses the schedule to determine when construction is falling behind, triggering a meeting of all parties to the contract, including the bonding company. The meeting is to determine the reason for delays, advise of the consequences of the delay and develop a plan to get construction back on schedule.
- C. Contract Documents. The Lender shall submit the following contract documents to HUD's architectural staff for **HUD review** prior to initial endorsement:
1. Building Loan Agreement, Form HUD-92441, and Construction Contract, Form HUD-92442 or 92442A.
 - a. Correct identification of drawings and specifications on forms.
 - (1) Project name, HUD project number, and design Architect's name.
 - (2) Drawings and specifications by sheets, pages and date or by index with date of last revision of sheet and page.
 - (3) Addendum by number and date.
 - b. Compliance with any architectural requirement or condition.
 2. Survey and Surveyor's Report, Form HUD-2457, must be reviewed:
 - a. For compliance with Survey Instructions and Certificate.
 - b. To confirm that legal description and survey property boundaries agree.
 - c. To assure that the surveyor's report is complete per instructions.
 3. Drawings and Specifications, three sets. Confirm that:
 - a. Master Set No. 1 and Sets No. 2 and 3 are the same as accepted and identified in the Firm commitment. Indicate total number of pages in the drawings and specifications.

- b. Cover sheets are signed by representatives of design Architect, Architect administering contract, owner, contractor, Lender, and bonding company, if any.
 - c. Master Set is initialed by signatories on the face of each sheet and page. (Signatories initial opposite any “last minute” revisions not covered by Firm Commitment or addendum.)
 - d. Lender signatory:
The Lender has an individual or individuals who are authorized to sign for the company at closing. One of the Lender’s authorized signatories must sign and initial the plans and specifications at initial closing (Appendix 5E). The Department should accept only the Lender’s authorized signatory. The Lender must supply the HUD Office with the name(s) of these individual(s).
4. Drawings and Specifications to be maintained by Lender, one set. Confirm that:
- b. Lender Set is the same as accepted and identified in the Firm commitment. Indicate total number of pages in the drawings and specifications.
 - c. Cover sheets are signed by representatives of design Architect, Architect administering contract, owner, contractor, Lender, and bonding company, if any.
 - d. Lender set is initialed by signatories on face of each sheet and page. (Signatories initial opposite any “last minute” revisions not covered by Firm Commitment or addendum.)
- D. If contract documents are correct, the HUD Team Leader will recommend Initial Endorsement. In the event of errors or inconsistencies, the contract documents will be returned to the Lender for correction and resubmission.
- E. Distribution of Drawings and Specifications.
1. After initial endorsement, the HUD Office will distribute drawings and specifications as follows:
 - a. Set No. 1, Master Set is the legal contract document. The HUD Office will:
 - (1) Retain this Set until the last guarantee inspection.
 - (a) Add copy of each Change Order, Form HUD-92437.
 - (b) Add copy of each Architect’s Supplemental Instruction.
 - (2) Package specifications in a tightly rolled bundle with drawings on the outside, attach memo indicating HUD project number, and send to the Regional Federal Records Center one year after completion of construction.
 - b. Set No. 2 is the HUD Office’s review set.
 - (1) HUD staff will use this set for processing change orders, review of inspections, and similar functions. Do not use Master Set.
 - (2) Dispose of this set after final endorsement.
 - c. Set No. 3 is the HUD Office’s job site set.
 - (1) The HUD Inspector uses this set for inspection of the project.

- (2) HUD Inspector conforms this set to the contractor's "record set." (Contractor is required to maintain at the site a record set for the Owner.)
 - (3) HUD Inspector returns this set to the HUD Office upon completion of construction. This set is the HUD "as-built" set.
 - (4) Use this set for guarantee inspections.
 - (5) Send HUD "as-built" set to the Hub Director, one year after completion of construction, for use in project servicing.
2. Drawings and specifications to be maintained by the Lender (Lender Set):
 - a. The Lender must maintain this Set for a period of three years after Final Endorsement.
 - (1) Add copy of each Change Order, Form HUD-92437.
 - (2) Add copy of each Architect's Supplemental Instruction.
 - b. If the Originating Lender does not administer the construction contract, the Construction Administrating Lender must forward copies of each Change Order and Architect's Supplemental Instruction to the Originating Lender for inclusion in the Lender Set.
- F. Early Start of Construction. Construction may not start before initial endorsement and recordation of the insured mortgage, except with the prior approval of the Hub Director. Any work performed after receipt by the HUD Office of the initial application for mortgage insurance, including clearing, grading or other preliminary work, constitutes the start of construction in this regard.

The following are mandatory conditions for approval of an early start of construction:

1. Firm Commitment. There must be a valid outstanding Firm Commitment, including:
 - a. Site control, and the right to legally access the site for purposes of construction.
 - b. HUD-approved set of contract drawings and specifications on file with the Department. See Appendix 5I for required firm commitment contract drawings and specifications.
 - c. Required construction contract and other construction documents, including, but not limited to:
 - (1) Construction Contract, Form HUD-92442 or HUD-92442-A;
 - (2) Supplementary Conditions of the Contract for Construction, Form HUD-2554;
 - (3) Applicable Davis-Bacon wage decision (supplied by HUD Labor Relations);
2. Assurance of Completion for On-Site and Off-Site. The early start may not hamper the ability to obtain a title policy at the time that the loan goes to initial closing.
3. Valid Basis for Early Start. The Hub Director must document the file, fully defining the rationale and compelling reason for granting an early start, after determining that:
 - a. An immediate closing is not practical.
 - b. There is reasonable evidence and assurance that closing will occur in the near future.
 - c. There is a compelling need to start construction before the anticipated closing date

- d. An early start of construction will not be detrimental to HUD's interests.
- e. HUD has no insurance obligation or liability whatsoever for costs incurred during an early start if the project does not reach endorsement.
4. The contractor, mortgagor and Lender must execute Form FHA-2415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, without change. The Hub Director or the Program Center Director must sign form FHA-2415.
5. Preconstruction Conference must be held before the start of any construction. See Chapter 13, Section 13.2.
6. Violations of Early Start Criteria must be referred to the Hub Director for a determination as to whether the project may proceed to initial endorsement.

5.8**HUD Procedures - Pre-Application Stage – New Construction**

- A. Lender will submit Pre-application deliverables (Section 5.6) to the HUD Office.
- B. HUD architectural analyst will examine the Architectural/Engineering (A/E) exhibits and will recommend either acceptance or rejection of the A/E portion of the Pre-application submission. Using the application and the sketch plans, the HUD architectural analyst will review:
 1. Conformance to HUD Standards.
 - a. HUD Minimum Property Standards.
 - b. Energy efficiency. Using the application, the analyst will review the proposed utility selection for the project to determine conformance with the HUD standard cited in Appendix 5A, Paragraph O. If it is determined that the utility selection is energy inefficient, the analyst will include a recommendation in the written report (See Appendix 5L) that the Hub Director require a life cycle utility analysis to be included in the Firm Commitment application.
 2. Site conditions including:
 - a. Placement of building(s) on the site;
 - b. Unusual site features;
 3. Residential building(s), including:
 - a. Circulation within the building(s);
 - b. Typical apartment layouts;
 - c. Typical apartment sizes. HUD appraisal staff will determine whether the apartment sizes are marketable for the proposed rents.
 - d. Overall structure and exterior finish.

- C. HUD architectural analyst will issue a written report (See Appendix 5L) containing recommendations and forward a copy to the HUD Team Leader.

5.9**HUD Procedures: Firm Stage – New Construction**

- A. Lender will submit Firm deliverables (Section 5.6) to the HUD Office. The HUD architectural analyst will examine the Lender's review, the underwriting summary and the A/E exhibits. The HUD analyst will review the quality of the Lender's review and the transaction itself. The HUD analyst will not reprocess the case. However, if the HUD analyst determines that certain underwriting conclusions are not supportable and affect HUD's risk, the analyst may recommend that the Lender modify the application or recommend a rejection. The Team Leader will approve, reject or modify the recommendation of the HUD Architectural analyst.
- B. The HUD architectural analyst will:
1. Review the Firm deliverables for completeness;
 2. Examine the Review Report and the A/E exhibits and will recommend either acceptance or rejection of the A/E portion of the Firm submission. HUD A/E recommendations will be based on areas of concern in the Review Report not covered at Pre-application stage, including:
 - a. Detailed site soils information resulting from test borings, including the presence of unstable soils or soil contaminants (See Appendix 5A, paragraph L);
 - b. Detailed examination of accessibility for persons with disabilities from the street throughout the site and into and throughout the residential and common non-residential structure(s) and space(s), with respect to the Fair Housing Act requirements and any other accessibility laws and HUD requirements that apply;
 - c. Site design, including placement of buildings and parking, erosion containment measures and site drainage; and
 - d. Building design, especially involving fire safety and structural adequacy.
 3. Review the A/E portion of completed Form HUD-92264 for accuracy with respect to the A/E exhibits.
 4. Review portions of the A/E exhibits for consistency with the Review Report. Check the following:
 - a. Site work and elevations;
 - b. Foundation design and placement;
 - c. Accessibility for persons with disabilities, from the street throughout the site and into and throughout the residential and common nonresidential structure(s) and space(s).
 - d. Any design features that are unusual for the particular structure type and or system.
 - e. Utility analysis if required by Hub Director at Pre-application review.

- C. The HUD architectural analyst will issue a written report (See Appendix 5L) containing recommendations and forward a copy to the HUD Team Leader.

5.10

HUD Procedures - Firm Commitment through Initial Endorsement – New Construction

- A. HUD architectural staff will review contract documents as indicated in Section 5.7.C prior to initial endorsement.
- B. If contract documents are correct, the HUD Team Leader will recommend Initial Endorsement. In the event of errors or inconsistencies, the contract documents will be returned to the Lender for correction and resubmission.
- C. The contract drawings and specifications will be distributed as indicated in Section 5.7.E.

5.11

General Lender Procedures – Substantial Rehabilitation

All of the previous instructions in this Chapter apply to substantial rehabilitation projects unless otherwise modified therein.

5.12

Definitions – Substantial Rehabilitation

- A. Substantial Rehabilitation - required repairs, replacements and improvements:
1. Involve the replacement of two or more major building components or,
 2. Costs of which exceed the greater of:
 - a. 15 percent (exclusive of any soft costs) of the property's replacement cost (fair market value) after completion of all required repairs, replacements, and improvements, or
 - b. \$6,500 per dwelling unit (adjusted by HUD's authorized high cost percentage).
- NOTE:** Estimates for determining the cost for substantial rehabilitation must include general requirements and fees for contractor's general overhead and profit, bond premium, mortgagor's and contractor's other fees and design architect and supervisory architect. However, when determining the eligibility of Section 223(f) projects, include only the repair costs; do not add general requirements and fees.
- B. Major Building Component. Roof structures; wall or floor structures; foundations; and plumbing, central heating and air conditioning systems, or electrical systems.
1. Major refers to the importance of the component and the extent of replacement.

- a. The element must be significant to the building and its use, normally expected to last the useful life of the structure, and not minor or cosmetic. Examples: Major: roof sheathing, rafters, framing members. Minor: shingles, built-up-roofing.
- b. Total replacement is not required, but the greater part (at least 50 percent) must be replaced.

5.13**Standards – Substantial Rehabilitation**

Substantial rehabilitation must comply with applicable local codes and ordinances. For a full listing of standards and guidelines for substantial rehabilitation projects, see Appendix 5B and 5D.

5.14**Architectural/Engineering Exhibits – Substantial Rehabilitation - Firm Stage**

In addition to the exhibits indicated in Section 5.5, the mortgagor shall submit the following exhibits for the Lender’s architectural analyst to review:

- A. Detailed scope of rehabilitation work resulting from joint inspection. (See Section 5.16)
- B. If an abnormal amount of time has elapsed since the joint inspection, or if property damage may have occurred, re-inspect the property to determine current physical condition and provide any necessary additional conditions for Firm Commitment.

5.15**Lender Deliverables – Substantial Rehabilitation**

In addition to the deliverables indicated in Section 5.6, the Lender will present the following deliverables to the HUD Office:

- A. Pre-application Stage (for HUD review):
 1. Sketch plans of the existing building(s) “as-is”.
 2. Basic Work Write-up: Description of the proposed rehabilitation (from preliminary inspection of the property conducted by mortgagor’s Architect), including post-rehabilitation sketch plans. This precedes the joint inspection and the Detail Work Write-up. (See Sections 5.16 and 5.17).
 3. Lead Based Paint (LBP) and asbestos test reports for projects constructed prior to 1978. (See LBP and asbestos standards in Appendix 5B, paragraph H, and Chapter 9 Sections 9.4.D and 9.7.B.).

B. Firm Stage:

1. Mortgagor's Architectural/Engineering exhibits for substantial rehabilitation (See Section 5.14).
2. Review Report prepared by Lender's architectural analyst covering the Scope of Rehabilitation Work (Section 5.16) and the Detail Work Write-up (Section 5.17).
3. Area and unit count breakdowns for multiple structure projects:
For projects containing multiple structures, provide an individual breakdown of gross floor area, net rentable area, and dwelling unit distribution (including net area and number of each unit type) for each typical building design.
4. Prepared architectural portion on Form HUD-92264, signed by Lender's architectural analyst under "Architectural Processor". When the project consists of more than one structure, the Lender must submit an itemized Gross Floor Area and Dwelling Unit Breakdown list, including unit count and unit areas, for each individual structure in the project.
5. Copies of Lender's architectural analyst's project files and logs only at the request of the HUD Office.
6. Standard certification by Lender's architectural analyst (see Chapter 11, Section 11.2).

5.16**Joint Inspection – Substantial Rehabilitation**

As soon as possible after the pre-application approval is issued by HUD, the lender should schedule an on-site inspection with the mortgagor.

A. Team Members.

1. Must include architectural and cost staff employed by the Lender, the mortgagor's Architect, and the general contractor. A representative of the local building department should be present. If not, the team must have a copy of the latest official inspection for compliance with local codes and ordinances.

B. Purpose.

1. Determine the project's condition, particularly concerning major defects, deterioration, and obsolescence.
2. Determine type and extent of work that would:
 - a. Appropriately rehabilitate the project for the intended occupants.
 - b. Result in reasonable operating costs.
 - c. Ensure continued marketability after rehabilitation.

- C. Scope. Since the joint inspection is the basis for the detail work write-up, cost estimate, commitment conditions and required exhibits, the inspection must be thorough and include:
1. All features of the project site; buildings and improvements, utilities, roads and parking, underground storage tanks, and surroundings.
 2. Sufficient living units to ascertain all necessary rehabilitation. This may range from selected typical units to all units depending on physical conditions.

5.17

Detail Work Write-up – Substantial Rehabilitation

The mortgagor's licensed Architect prepares the detail work write-up reflecting the work agreed to, based on the joint inspection. However, the mortgagor's Architect may bypass the detail work write-up stage and proceed directly to preparation of drawings and specifications that describe clearly the work agreed to, in lieu of a work write-up. (Bypassing the work write-up stage should be approved by the Lender's architectural analyst.) Because there is no initial deposit to the Reserve for Replacements for substantial rehabilitation, the scope of work must provide for the replacement of all doors, windows roofs, cabinets, and mechanical/conveyance systems (e.g. elevators, plumbing, boilers/furnaces, ventilation/air conditioning, electrical) which are at or near the end of their useful lives. The rehabilitation must result in a structure which will require no complete replacement of doors, windows, roofs, cabinets, or mechanical/conveyance systems for at least five years.

- A. The detail work write-up must describe in narrative form the required rehabilitation. Divide as follows:
1. General Requirements.
 - a. Include work items applicable to all elements in the project, for example: site work, exterior work; painting and decorating; rehabilitation of kitchens, bathrooms, roofs, mechanical systems, electrical systems, interior walls, floors, windows and doors, etc.
 - b. For projects that contain Lead Based Paint (LBP) and/or asbestos:
 - (1) The mortgagor or its Architect is responsible for engaging the services of a qualified LBP and/or asbestos abatement contractor(s) to prepare a scope of work for the abatement of LBP and/or asbestos. Where the scope of abatement work consists of permanent enclosure or encapsulation, but not removal, of LBP and/or asbestos, the qualified abatement contractor(s) must also prepare, separate from the scope of abatement work, an Operations and Maintenance (O&M) Plan for LBP and/or asbestos. The O&M Plan contains ongoing maintenance activities for LBP and/or asbestos, to be followed for as long as the LBP and/or asbestos remains in place. All abatement work and ongoing maintenance activities for LBP and/or asbestos shall conform to the following Regulatory requirements:
 - (a) For LBP, 24 CFR Part 35.
 - (b) For asbestos, 40 CFR Part 61.

- (2) The Lender must certify that the mortgagor has prepared an O&M Plan and that the Plan will remain in effect for the life of the mortgage.
 - (3) A certification from the Lender to this effect is a mandatory condition for Firm Commitment and a required exhibit at Initial Closing.
2. Special Requirements. Describe work for a specific item, room, space, unit, or building.
- B. All requirements must be specific and state the location, type and amount of work to be done. Do not use general phrases, such as, “repair or replace” or “as required”.
 - C. In case of a complete gut rehabilitation project, where only the structure will remain and the drawings and specifications will be as detailed as for new construction, the detail work write-up need only to be detailed enough to be a basis for the cost estimate and serve as a memorandum of understanding between the Field Office and the mortgagor.
 - D. Historic requirements including State Historic Preservation Office (SHPO) review, etc.

5.18**Contract Documents – Substantial Rehabilitation**

Because the nature and extent of rehabilitation may vary widely among individual projects, the requirements for specific contract documents cannot be determined by the Lender’s architectural analyst until the joint inspection and work write-up are complete. When the contract documents are received, the Lender’s architectural analyst must compare the documents to the detail work write-up to confirm that the scope of work contained in the contract documents conforms to the scope of work in the detail work write-up.

- A. Drawings. When required, drawings must clearly define the concept and detail of the rehabilitation, any demolition or removal, and repairs and replacements.
 1. Require complete drawings and details similar to those for new construction if the structure will be gutted, or there will be structural modification or addition to the existing structure.
 2. For projects with minor changes in space arrangement, structural or mechanical systems, require only drawings sufficient to show existing conditions and proposed work.
 3. Do not require drawings if the rehabilitation can be clearly and completely described in specification format.
- B. Specifications. Work write-up/specifications are always required and must clearly define the scope of the rehabilitation, establish the quality of materials and workmanship, and the conditions of construction.

5.19**Engineering Reports – Substantial Rehabilitation**

Surveys or special technical reports may be required of the mortgagor by the Lender for proper evaluation of the project, and the Lender will:

- A. Notify the mortgagor by letter immediately after the joint inspection of any requirement for such report.
- B. Clearly state the exact nature of the engineering or technical investigation and the items to be covered.
- C. Specify any special tests, such as pressure or flow tests of plumbing or cutting of pipe for examination.
- D. Specify seismic resistance for substantial rehabilitation projects. Structures in seismic zones 3 and 4 must be capable of resisting three fourths (3/4) of the seismic forces contained in FEMA-310, Handbook for the Seismic Evaluation of Buildings – A Pre-standard, FEMA-356, Pre-standard and Commentary for the Seismic Rehabilitation of Buildings, and FEMA-274, NEHRP Commentary on the Guidelines for Seismic Rehabilitation of Buildings.
 1. A seismic hazard analysis of the building(s) should be conducted by a registered engineer familiar with lateral force design, where applicable code requirements at the time of construction did not equal or exceed the referenced seismic standards.
 2. The analysis should include an examination of the structure for continuity, ductility, and resistance to lateral forces.
 3. Structural elements and connections between elements should be strengthened and retrofitted as required, if the existing structure does not provide three fourths (3/4) of the seismic force level resistance required. The objective is to prevent major failures, collapse or loss of life due to earthquake forces.
- E. Work write-up cannot be completed until all required engineering reports are analyzed by the Lender's architectural analyst and a determination is made in regard to the need for additional rehabilitation requirements.

5.20**Required Professional Services – Substantial Rehabilitation**

The services of an architect or engineer, licensed to practice architecture or engineering in the state in which the project is located, are required for design and construction of a rehabilitation project. In addition to the production of working drawings and specifications necessary to define the scope and

concept of the rehabilitation, professional services are required whenever:

- A. Change of building use is proposed, existing spaces are to be altered, or structural changes are necessary, and/or
- B. An addition is proposed to the existing structure.

5.21**HUD Procedures - Pre-application Stage –
Substantial Rehabilitation**

- A. Lender will submit pre-application deliverables (Sections 5.6 and 5.15) to the HUD Office.
- B. In addition to procedures in Section 5.8.B, the HUD architectural analyst will examine the Basic Work Write-up.
- C. HUD architectural analyst will issue a written report (Appendix 5L) containing recommendations and forward a copy to the HUD Team Leader.

5.22**HUD Procedures: Firm Stage – Substantial
Rehabilitation**

- A. Lender will submit Firm deliverables (Sections 5.6 and 5.15) to the HUD Office.
- B. In addition to procedures in Section 5.9.B, the HUD architectural analyst will examine the detail Work Write-up.
- C. HUD architectural analyst will issue a written report (Appendix 5L) containing recommendations and forward a copy to the HUD Team Leader.

5.23**Section 223(f) – General**

In general, all the previous instruction in this chapter applies to projects insured pursuant to Section 223(f), except as modified herein.

5.24**Section 223(f) – Standards**

Eligible properties are existing construction. The criteria for acceptance are not the same as for proposed

construction. See Appendix 5C for a complete description of architectural standards for 223(f) projects.

A Fair Housing Act Accessibility Considerations for Section 223(f):

If a project containing four or more units available for first occupancy after March 13, 1991, does not meet all of the design and construction requirements of the Fair Housing Act, the project must be modified/retrofitted to meet these requirements as a condition of mortgage insurance. These structural modifications/retrofits of the project must meet the following conditions:

1. Except in extraordinary circumstances, modifications/retrofits of the public and common areas of the project must commence within thirty days of the Initial/Final Closing date.
2. Individual units.
 - a. Modifications/retrofits for individual units in the project must be scheduled to commence within sixty days after the Initial/Final Closing date.
 - b. Advance notice to tenants. Immediately after the issuance of the Firm Commitment, tenants must receive written notification indicating the modifications/retrofits to be performed, the anticipated start date and work schedule, and, if necessary, the schedule of temporary relocation for each unit.
3. In all cases, once these structural modifications/retrofits are begun, the work should be completed without unreasonable delay. All structural modifications/retrofits must be completed within one year after the Initial/Final Closing date. See Appendix 5C, paragraph E.
4. All such modifications/retrofits must conform to the escrow and inspection requirements contained in Chapter 13, Section 13.17.

B. Aluminum Wiring Considerations for Section 223(f):

This concerns properties built in the 1970s containing aluminum wiring whose specifications were subsequently banned by the National Electric Code, because of a history of overheating and electrical fires. Because they were built during the brief time that such wiring was legal, current codes may not require these properties to upgrade the wiring.

1. The Department will not insure any mortgage for these properties under Section 223(f) without measures being taken to mitigate the hazard posed by the 1970s aluminum wiring.
2. Mitigating measures will be carried out in accordance with the latest edition of the National Electrical Code.
3. These mitigating measures may be treated as non-critical repairs.
4. In addition to the repair work, the owner of the property must carry sufficient property insurance to accommodate the increased risk posed by the 1970s aluminum wiring.

C. Smoke Detectors for Section 223(f)

1. Smoke detectors are required for Section 223(f) by both the Life Safety Code (NFPA 101) and HUD Regulation (24 CFR 200.76). Installation of required smoke detectors is a Critical Repair.
2. Battery operated smoke detectors are permitted under certain conditions. See Appendix 5C, paragraph C.4 and 5D, paragraph B.

5.25**Section– 223(f) - Lender Deliverables**

The Lender will present the following deliverables to the HUD Office:

A. A complete Project Capital Needs Assessment and Replacement Reserve Escrow (PCNA) Report (See Appendix 5M) prepared by the Lender and described in Section 5.26 below.

B. Lender’s review of PCNA Report.

The Lender must conduct an independent review of the PCNA report. Neither the individual who inspected the property and prepared the PCNA (the Needs Assessor – see Appendix 5H), nor the firm that employed the Needs Assessor, is eligible to review the PCNA report. The Lender must use an independent third party to review the PCNA report.

C. A completed A/E portion of Form HUD-92264. When the project consists of more than one structure, and where no measured architectural drawings are available, the Lender must prepare a Dwelling Unit Breakdown list, including unit count and unit areas, for each individual structure in the project. In addition, the Lender must submit an estimate of the Gross Floor Area for each individual structure in the project, based on the best estimate of the Needs Assessor.

D. Mortgagor’s Exhibits. The mortgagor shall submit the following exhibits for the Lender’s architectural analyst to review:

1. Form HUD 92013.
2. Certificate of Occupancy or Final Inspection Report, if available or a statement from the jurisdiction of authority recognizing conforming use.
3. Municipal Code Violation Report/Clear Report and Fire Marshall’s Report/Clear report.
4. City/County Health Officer’s report/clear report where private water supply or sewage treatment systems are involved.
5. “As Built” Survey, Form HUD-2457, Surveyor’s Report; and Title Report. For specific survey requirements for Section 223(f) projects, see Appendix 5C, paragraph F.
6. Set of as built plans, if available.
7. Location map.

5.26**Section 223(f) - Project Capital Needs Assessment and Replacement Reserve Escrow**

The Lender prepares the PCNA and Replacement Reserve Escrow in accordance with Appendix 5H.

A. PCNA submission requirements.

1. Date of PCNA. The PCNA must be prepared and dated no earlier than 120 days prior to the submission of the application for Firm Commitment. The date of the PCNA is the date that the actual physical inspection of the property was performed by the Needs Assessor.
 2. Updating of PCNA. In the event that the Lender fails to submit an acceptable application for Firm Commitment within the 120-day window from the date of the original physical inspection, then the Lender must order an updated PCNA. The Needs Assessor must re-inspect the subject property, updating any structure and/or site conditions observed, and date and sign a new Third Party Certification.
- B. The PCNA consists of the following:
1. A Physical Inspection Report (PIR) containing detailed information about:
 - a. The condition of the project.
 - b. Identification of the project's:
 - (1) Immediate repair needs; and
 - (2) Expected repair, replacement, and major maintenance needs over a specified time period such as ten years.
 - c. An estimated cost, adjusted for inflation, to complete such items.
 2. A Statement of Resources and Needs which discusses:
 - a. The Lender's review of and possible adjustment to the PIR;
 - b. Identifies:
 - (1) All critical repairs which must be completed before initial/final endorsement and the associated cost of doing the work.
 - (2) Non-critical repairs to be completed after final endorsement and the associated cost to be escrowed.
- C. Repair requirements.
1. All contemplated repairs, whether completed before or after Initial/Final Endorsement, must be fully described in the PIR, which is a required part of the PCNA.
 2. No repairs may be started before the Section 223(f) application, which includes the PCNA, is submitted to the Department. After the submission, no repairs may be started until the Department issues a Firm Commitment.
 3. Requests to start repairs before a Firm Commitment is issued will not be accepted.
- D. Repairs to be completed after Initial/Final Endorsement. It is the Department's preference that non-critical repairs be completed before loan closing; however if the mortgagor wishes to defer non-critical repairs until after closing, the following instructions set specific conditions that the mortgagor must meet.
1. General.

- a. Only non-critical repairs may be deferred. Non-critical repairs are those that will not:
 - (1) Endanger the safety and well-being of tenants, visitors and passersby;
 - (2) Adversely affect ingress or egress; or
 - (3) Prevent the project from reaching sustaining occupancy.
 - b. The repair deferral provision may be used only with the approval of the Hub or HUD Program Center Office.
 - c. Operating deficit determinations must consider occupancy disruptions to any units due to deferral of repairs.
 - d. After initial/final endorsement, work on deferred repairs must begin immediately.
2. Escrow Agreement (Form HUD-92476-1).
- a. The costs of the deferred repairs (including materials, labor, permits, profits, etc., trended to the start of repairs) must be estimated and withheld **in cash** from mortgage proceeds and placed in escrow. A letter of credit may **not** be substituted for this 100 percent escrow.
 - b. An additional cash amount (or letter of credit, at the option of the Lender) of not less than 20 percent of the repair cost estimate will also be placed in escrow.
 - c. The Lender may release funds from the mortgage proceeds portion of the escrow in proportion of the cost of work completed, less a 10 percent holdback. The holdback amount must be held until all work is completed and found acceptable.
 - d. Funds remaining in the escrow account, including the holdback portion, may be released when:
 - (1) All repairs have been satisfactorily completed;
 - (2) Evidence of clear title has been provided to the HUD Office; and
 - (3) Latent defects assurances have been provided by one of the following:
 - (a) An escrow in cash, or letter of credit at the option of the Lender, equal to 2 ½ percent (or greater percentage as warranted) 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.
 - (b) A Surety Bond covered by HUD Form 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).

3. Completion of Repairs.
 - a. The Replacement Reserve Account shall not be used for the completion of any repairs, rehabilitation, or construction items (See Appendix 5H, paragraph IV.A).
 - b. The mortgagor must complete all repairs (see Appendix 5H, paragraph III.E) within twelve (12) months of endorsement (or such shorter period as HUD and the Lender may specify).
 - c. If the mortgagor has not completed all repairs by the end of the repair period (including any approved extensions), the Lender will complete the repairs using the escrowed funds. The Lender will provide the mortgagor with a breakdown of these repairs and the cost(s) of completion (including administrative expenses). Funds remaining in the escrow account after completion of the repair work will be returned to the mortgagor less reasonable administrative costs incurred in completing the repairs.
 4. Requirements after Completion of Repairs. In cases where actual costs are less than estimated, the maximum insurable loan amount must be recalculated. If the maximum insurable mortgage is cut due to lower actual costs, the mortgagor must prepay the mortgage:
 - a. In amounts equal to the scheduled monthly principal payments, to the extent possible; with
 - b. Any remainder going to the Reserve for Replacements Fund.
 5. Exemption for Repairs for Tax-Exempt Bond Financed Projects. Project repairs which are required to satisfy tax code requirements but not required for Section 223(f) program compliance are exempt from Provisions 1 through 4 above, but must meet the following:
 - a. The costs of the repairs cannot be considered in the determination of the value of the project (for mortgage insurance) or the computation of the maximum insurable mortgage.
 - b. The repairs must not be necessary for the project (or any unit in the project) to command the rent levels used in processing.
 - c. The repairs must not delay or interrupt the occupancy of any unit in the project.
 - d. Repairs must be paid from sources other than mortgage proceeds, secondary financing, or the required repair escrows.
 - e. Funds for these repairs must not be commingled with the Section 223(f) escrow.
- E. Owner-Proposed Repairs and/or Improvements.

All owner-proposed repairs and/or improvements are considered Non-Critical Repairs. See Appendix 5H.

5.27

Section 223(f) - HUD Procedures - Firm Stage

- A. Lender will submit deliverables (Section 5.25) to the HUD Office. The HUD architectural analyst will examine the Lender's PCNA Report, the underwriting summary and the mortgagor's exhibits. The HUD analyst will review the quality of the Lender's report and the transaction itself. The HUD analyst will not reprocess the case. However, if the HUD analyst determines that certain underwriting conclusions are not supportable and affect HUD's risk, the analyst may recommend that the Lender

modify the application or recommend a rejection. The Team Leader will approve, reject or modify the recommendation of the HUD architectural analyst.

B. The HUD architectural analyst will:

1. Examine the following documents:

- a. The Project Capital Needs Assessment and Replacement Reserve Escrow (PCNA) Report;
- b. Lender's review of PCNA Report;
- c. A/E portion of completed Form HUD-92264;
- d. Mortgagor's Exhibits.

2. Recommend either acceptance or rejection of the A/E portion of the submission. HUD A/E recommendations will be based on a comparison of selected areas of concern in the PCNA Report with the Mortgagor's Exhibits. At a minimum, consider Critical Repairs covering health and safety (and accessibility for persons with disabilities for projects built after March 13, 1991).

C. HUD architectural analyst will issue a written report (Appendix 5L) containing recommendations and forward a copy to the HUD Team Leader.

CHAPTER 6

SUMMARY OF MAJOR CHANGES IN CHAPTER 6 OF THE MAP GUIDE

Cost Analysis

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, **4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance**, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 6 specific revisions in the new release:

- Section 6.2 - Section 231 was added.
- Section 6.3.C – Section modified to eliminate site not attributable (SNA) for dwelling use from the calculation maximum mortgage amount under Criteria 4 per family unit limits. SNA was used to account for the land value associated with cost not attributable items. The land value was always thought to have been included within Criteria 4. However the statute does not state that the value of land is included.
- Sections 6.12 – 6.13 - References to Section 232 deleted, as this program has been transferred to Office of Insured Health Care.

6.1

Qualifications, Responsibilities, and Approval of the Lender's Cost Estimator

- A. Qualifications of Lender's Cost Estimator - The Lender shall hire a qualified construction cost estimator with experience in multifamily cost estimating. The estimator must be knowledgeable and experienced with local building standards and construction costs for the type of project proposed. A cost estimator may also serve as the architectural analyst if the qualifications are met.
- B. Responsibilities of Lender's Cost Estimator - The cost estimator shall provide an independent cost analysis for the proposed project. This estimate is not limited to any one specific method. However, the method chosen must be one recognized by the construction industry. This detailed cost estimate must conform to HUD's line item format as shown on Form HUD-2328, Contractor's and/or Mortgagor's Cost Breakdown.

HUD Approval of the Lender's Cost Estimator - The Department reserves the right to examine the credentials of all cost estimators hired by the Lender, and to reject any and all individuals that it considers unqualified.

6.2

Section 221(d), Section 220, and Section 231 Lender Responsibilities and Deliverables

A. Responsibilities

A complete construction cost analysis must be submitted with the Firm Commitment application. The Cost Analyst's responsibilities are:

1. Preparation of detailed project cost estimate.
2. Completing Cost portions of Form HUD-92264, Project Income Analysis and Appraisal.
3. Reviewing and approving or disapproving the Contractor's and/or Mortgagor's Cost Breakdown, Form HUD-2328.
4. Preparation of Form HUD-92329, Property Insurance Schedule. Note that Form FHA-2447, Property Insurance Requirements, will be prepared by HUD and provided to the Lender at closing. (See MAP Forms Book.)
5. Reviewing and approving or disapproving requests for prior approval of identity of interest subcontractors.

6. Estimate costs of Replacement Reserve items (for substantial rehabilitation). Note that there is no initial Replacement Reserve for complete (gut) rehabilitation. See Chapter 7 for instructions.
7. Providing advice and assistance on cost matters to mortgagors, consultants, contractors, and others.

B. Deliverables

1. Firm Stage - Cost Estimate Package:
 - a. Detailed Cost Estimate. To be reported on Form HUD-92326:
 - (1) Detailed structure(s) and land improvement cost estimates, for new construction and substantial rehabilitation, and costs of unusual site development.
 - (2) Contractor's General Requirements, General Overhead and Profit, and Architect's Design and Supervision fees.
 - (3) Bond Premium and Mortgagor's and Contractor's Other Fees.
 - (4) Onsite Demolition costs.
 - (5) Off-site improvement costs.
 - (6) Project's Cost Not Attributable (CNA) to dwelling use.
 - b. Preparation of Cost portions of Form HUD-92264, Project Income Analysis and Appraisal, signed by Lender's cost analyst under "Cost Processor."
 - c. Preparation of Form HUD-92329, Property Insurance Schedule. Note that Form FHA-2447, Property Insurance Requirements, will be prepared by HUD and provided to the Lender at closing. (See MAP Forms Book).
 - d. Review the Contractor's and/or Mortgagor's Cost Breakdown:
 - (1) Submit Form HUD-2328, Contractor's and/or Mortgagor's Cost Breakdown.
 - (2) Review of Form HUD-2328, Contractor's and/or Mortgagor's Cost Breakdown, and recommendation for approval or disapproval. Review must include a trade line item comparison of Form HUD-2328 and the estimator's cost estimate (Form HUD-92326), which is to be provided on Form HUD-92331.
 - (3) Signatures. The Lender's cost analyst must sign and date Form HUD-2328 in the FHA: Processing Analyst box. The Lender's Underwriter must sign and date Form HUD-2328 in the FHA: (Chief, Cost Branch or Cost Analyst) box. The FHA (Chief Underwriter) line will be endorsed by both the HUD cost reviewer and the HUD Team Leader.
 - e. For substantial rehabilitation (in addition to the above):

- (1) Joint work write-up;
- (2) Replacement Reserve estimate (See Chapter 7);
2. Identity of Interest and 50-75 Percent Rule Disclosure. (See Chapter 13, Section 13.15 for 50-75 Percent Rule instructions.)
 - a. Identification of any identity of interest relationship(s) between or among:
 - (1) Mortgagor,
 - (2) Mortgagor's Architect,
 - (3) General contractor,
 - (4) Subcontractor(s),
 - (5) Material supplier(s),
 - (6) Equipment lessor(s),
 - (7) Manufacturer(s) of industrialized housing.
 - b. Identification of any subcontractor(s) that violate the 50/75 Percent Rule by analysis of Form HUD-2328.

6.3

The Lender's Cost Estimate

PURPOSE. The replacement cost estimate is one of the criteria used to determine the mortgage amount to be insured. It consists of estimates of the new construction and/or substantial rehabilitation costs of all proposed improvements to the property.

- A. **Method of Estimation.** The method should be similar to that used by general contractors. Data should be organized by trade division using the Construction Specification Index (CSI) Format, and adjusted to reflect cost differences due to time, location and price fluctuations. The cost estimate may be prepared using a quantity survey takeoff or a square-foot and per-unit cost approach using established data and making adjustments.
- B. **Data.** The data source used to prepare the cost estimate must be documented. Acceptable cost data may come from completed comparable projects, benchmark amounts taken from actual project costs, and published data from construction cost data publishers.
- C. **Detailed Cost Estimates.** Use detailed plans and specifications supplied by Lender's architectural analyst as indicated in Chapter 5, Section 5.5 as a basis for the cost estimate. Estimates must reflect the general level of construction costs in the locality where construction takes place. Costs must be projected to the estimated construction start date. Davis-Bacon labor wage rates must be used. (Current Davis-Bacon wage rates will be supplied by HUD. See Chapter 5, Section 5.4). The cost estimate is tabulated on Form HUD-92326, and totals are reported in Sections G, M, and

O of Form HUD-92264. (See MAP Forms Book for all HUD forms). The cost estimate consists of the following items:

1. Structures and Land Improvements include:
 - a. Dwelling structures. Costs of all residential buildings including footings and foundations. Costs must be organized in the Construction Specification Index (CSI) trade item format. Report trade costs in Divisions 3 through 16 on Form HUD-92326.
 - b. Garages include all covered parking, from individual carports to complete parking structures. Include free-standing garage structures with other accessory buildings on the Accessory Structures line on Form HUD-92326. On Form HUD-92264, garages are reported separately on Line G.39.

Exception: Where a garage structure serves as a base for the dwelling structure (common practice in high-rise reinforced-concrete apartment buildings), include the garage trades with the Dwelling Structure trade items; do not report separately on either Form HUD-92326 or HUD-92264.

- c. Accessory buildings. Include costs on the Accessory Structures line on Form HUD-92326 and on Line G.38 of Form HUD-92264.

Exception: Where accessory uses are not placed in a separate building but rather occupy space within the residential structure(s), include the spaces within the Dwelling Structure trade items; do not report separately on either Form HUD-92326 or HUD-92264.

- (1) Community structures include non-residential uses intended for all project residents but not open to nonresidents. These include clubhouses, meeting halls, exercise rooms, etc.
 - (2) Commercial structures include non-residential, commercial uses that derive their income from both project residents and the general public.
 - d. Onsite land improvements make up the following trade line items on Form HUD-92326: Earthwork, Site Utilities, Roads and Walks, Site Improvements, Lawns and Planting, and Unusual Site Conditions.
 - (1) Unusual land improvements are items not typical to most construction in the locality such as, excessive excavation, rock excavation, cuts and fills, special foundations, high water table, problem soils, etc. These items are taken from the Unusual Site Conditions trade line item on Form HUD-92326, and are reported separately on Line G.36a of Form HUD-92264. A cost analyst works with the appraiser to determine existence of condition.
 - (2) Other land improvements are the typical site-work items (Earthwork, Site Utilities, Roads and Walks, site Improvements,

Lawns and Plantings) taken from the Land Improvement trade line items on Form HUD-92326, and are reported on Line G.36b of Form HUD-92264.

- e. Offsite extensions of roads, walks, and utilities immediately adjacent to project boundaries. See Section 6.3 C.2.b. (2) below for more details.
2. Supplemental Cost Estimates include:
 - a. Demolition. This is onsite work to remove existing structure, footings, foundations, and utilities to prepare the site for new construction.
 - (1) Include the removal and disposal of debris and fill and compaction of excavations. Include general contractors' and subcontractor's overhead and profit in the estimate.
 - (2) Report on Form HUD-92326, under "demolition," and Form HUD-92264, Section O. Appraiser will report Demolition costs in Section J of Form HUD-92264.
 - (3) Demolition should not be included in the construction contract.
 - (4) Outside demolition does not include interior demolition within existing structures undergoing substantial rehabilitation. See Section 6.6.B.1.b. (1)(a).
 - b. Offsite work that is not immediately adjacent to project boundaries.
 - (1) Include utilities, walks, curbs, gutters, streets, drainage structures, landscaping, etc., that extend away from the project site. These improvements are not included in the construction contract. Report on Form HUD-92326 and Section M of Form HUD-92264.
 - (2) Do not include short offsite extensions of onsite utilities, walks, curbs and drainage structures that connect with those immediately adjacent to the project site. These short extensions, and improvements such as sidewalks and curbs adjacent to the property lines, should be considered onsite improvements and included in the construction contract.
3. Cost Not Attributable to Dwelling Use (CNA) consists of certain project amenities and uses other than dwelling uses. CNA is calculated by the cost analyst and used by the appraiser to increase the maximum mortgage amount under Criterion 4 of Form HUD-92264-A. Include these costs within the estimate of total structures and land improvements; also itemize the costs and report separately in Form HUD-92326 and Section M of Form HUD-92264.
 - a. CNA for new construction.
 - (1) For new construction projects, CNA is calculated as a percentage. The CNA percentage consists of the ratio of the cost of the non-attributable spaces and facilities (abbreviated "B") to the total

cost of land improvements and structures (abbreviated "A"), known as the B over A ratio, or simply B over A.

- (2) B over A Ratio. Costs are generally based on gross floor area of the building, area of exterior site improvements, and/or lump sums.

(a) To calculate "B" costs:

- (i) Prepare a worksheet describing by category each item considered in CNA, showing the calculation of the cost of each item. Do not include General Requirements or fees in the calculation.
- (ii) Show the basis of measurement and the unit price.
- (iii) Summarize the categories and total in Form HUD-92326 and Section M of Form HUD-92264.

(b) To calculate "A" costs:

- (i) "A" is the sum of Total Structures and Total Land Improvements, before General Requirements or fees are added. To calculate "A", add the amounts in lines 36c and 41 in Section G of Form HUD-92264.

(c) To calculate B over A:

- (i) Divide the "B" costs by the "A" costs. Express as a percentage and enter in Section M of Form HUD-92264.

(d) For a complete example of calculating CNA, see Appendix 6D.

b. CNA for substantial rehabilitation.

- (1) CNA for substantial rehabilitation projects is determined in a different manner from CNA for new construction. Under this method, CNA rehabilitation work, and "as is" CNA value, are combined to produce a single dollar amount. For determining Rehabilitation CNA Fee, see the worksheet in Appendix 6C and the example in Appendix 6D.

- (2) Open-air parking lots and other open air CNA uses in a substantial rehabilitation project. A procedure has been developed to prevent open-air CNA uses covering large site areas, such as parking lots, tennis courts, etc., from distorting the amount of Rehab CNA. See the Rehab CNA worksheet in Appendix 6C and the example in Appendix 6D.

c. CNA Categories. There are two main CNA categories, Residential and Commercial. Each is calculated independently of the other and each has a maximum limit of 15 percent,

resulting in a total CNA of up to 30 percent. (See the Example in Section 6.3.C.3.d below). Every CNA use must be categorized either as Residential or Commercial, **but not both**. Note: that any request to waive these limitations must be documented and justified in accordance with the provisions of Chapter 11, Section 11.2.

- (1) Residential CNA. This consists of non-attributable items solely for the use of residents of the project. Items to consider as not attributable to dwelling use are:
 - (a) Parking areas and the walks and driveways specifically leading to them and serving them. Do not include public roads and streets, or walks and driveways that lead to and serve the building entrance.
 - (b) Garages, garage spaces, and covered parking, and the walks and driveways leading to them, excluding public roads and streets.
 - (c) Other improvements include:
 - (i) Community space, such as: multipurpose rooms, game rooms, lounges, libraries, and hobby or craft rooms, but **not** including furniture or movable equipment.
 - (ii) Project administrative and maintenance spaces, such as: offices, repair shops, employee toilets, and janitor or cleaning closets, but **not** including furniture or movable equipment.
 - (iii) Storage facilities not for occupant use.
 - (iv) Recreational facilities, such as: swimming pools, tennis courts, basketball courts, and tot lots, but not including furniture or movable equipment.
 - (v) Works of art that are fixed in place, such as wall murals or permanent ornamental fountains.
 - (d) Special Exterior Land Improvements are features unusual or in excess of those typical in projects for similar occupancy.
 - (i) Include such items as patios, sitting areas, and gazebos for the use of all project occupants. Include fountains and pools, exterior works of art, unusual trees and shrubs, and ornamental lighting and fencing.
 - (ii) Do not include typical earthwork, roads and walks leading to and serving the dwellings, typical lawns and plantings, private balconies

and patios, utility lines, retaining walls, or security lighting and fencing.

(2) Commercial CNA

This consists of areas or buildings and improvements intended for the use of the public as well as project residents. The most common commercial uses in residential developments are:

- (a) Shops,
- (b) Offices, and
- (c) Public parking.

Include only the basic and permanent structural improvements typical in vacant commercial space. Do not include equipment, fixtures, movable partitions, special finishes, etc., for a specific business.

d. Limitation on CNA

(1) Residential CNA: The B over A ratio for residential CNA should not exceed 15 percent. This is exclusive of any commercial space in the project, which will have a separate commercial CNA.

(2) Commercial CNA. Commercial CNA applies to commercial space such as shops that are in a residential structure, but serve the general public as well as the residents. This is calculated separately from residential CNA. The B over A ratio for commercial CNA should not exceed 15 percent. The Lender's underwriter should be aware of the higher risk inherent in commercial space and take special care to evaluate the commercial market in order to determine the maximum commercial space that can be included in the project without imposing undue risk.

Example: A project has residential CNA of 12 percent, and commercial CNA of 7 percent. Each CNA category is within the 15 percent guidelines. Total CNA for the project is 12 percent residential plus 7 percent commercial, equaling 19 percent.

(3) CNA Limits for Substantial Rehabilitation projects: Regardless of the method of determining Rehab CNA, there is a CNA ceiling for sub rehabilitation.

Use the B over A ratio to determine the CNA ceiling for sub rehabilitation, the same as for new construction. Even though B over A is not to be used for actual dollar amounts for sub rehabilitation projects, it is a legitimate tool for determining a CNA ceiling for sub rehabilitation. Use 15 percent as the ceiling for residential CNA rehabilitation work and another 15 percent as the ceiling for commercial CNA rehabilitation work.

Note that, in a sub rehabilitation project, the cost ("B") of the non-attributable

rehabilitation work does **not** include the “as-is” value of the existing CNA use. The cost (“A”) of the total rehabilitation work includes all structures rehab work and land improvement rehabilitation work, but **not** any “as-is” value.

When a project contains both residential and commercial CNA, and both residential and commercial CNA are determined to be acceptable using the above B over A tests, the residential and commercial CNA may be combined in a single Rehab CNA procedure. See the example in Appendix 6D.

- e. Items not to be included in CNA:
 - (1) Dwelling units. No portion of any dwelling unit, or any balcony or patio solely for the private use of the resident of the individual dwelling unit, is to be included in CNA.
 - (2) Utility rooms. Do not include utility rooms or portions of basements devoted to utilities such as boilers or furnaces, hot water heaters, water and sewer mains, gas mains, or electrical panels or closets.
 - (3) Circulation elements. Do not include entrances, lobbies, halls, corridors, stairs, and elevators used by the occupants to enter and leave dwelling units. Do not include roads and walks that lead to and serve the dwellings.
 - (4) Prorating of circulation elements. A prorating of circulation elements between dwelling use and any category in CNA is not permitted.
 - (5) Movable items that are not part of the real estate, such as:
 - (a) Movable equipment such as desks, furniture, computers and television sets.
 - (b) Easel paintings and movable sculptures.
 - (c) Movable gymnasium equipment.
 - (6) For commercial CNA, do not include equipment, fixtures, movable partitions, special finishes, etc., for a specific business.
- 4. Allowances and Fees are reported on Forms HUD-92326 and HUD-92264 as lump sum dollar amounts. Depending upon data, they may be calculated either as lump sums, or as percentages of subtotals which are converted to dollar amounts.
 - a. General Requirements (Job Overhead). Covers project specific overhead expenses. Calculate as a percentage of the sum of Total Land Improvements and Total Structures. The percentage amount is determined by the nature, difficulty, size of the project, and the characteristics of the neighborhood.
 - (1) Include:
 - (a) Supervision and job-site engineering;

- (b) On-site job office expenses directly related to the project including clerical wages;
- (c) Temporary buildings, tool sheds, shops, and toilets,
- (d) Temporary heat, water, light and power for construction;
- (e) Temporary walkways, fences, roads, siding and docking facilities, sidewalk and street rental;
- (f) Construction equipment rental not included in trade item costs;
- (g) Cleanup and disposal of construction debris;
- (h) Medical and first aid supplies and temporary facilities;
- (i) Security guard wages and related costs;
- (j) Theft and vandalism insurance. (does not include Builders Risk Insurance).
- (k) Builders Risk Insurance (only if paid for by General Contractor).

Builders Risk Insurance is separate from any theft and vandalism insurance policy taken out by the general contractor. While Builders Risk Insurance may be taken out either by the general contractor or the Mortgagor, it is common industry practice for the contractor to take out the policy, with the contractor named as Insured, and the Mortgagor named as "Other Insured." Regardless of which party pays for the policy, the Mortgagor must always be named as an Insured party, as per Builder's Risk Insurance requirements in FHA Form 2447, Property Insurance Requirements. If the contractor pays for the policy, the premium belongs in the construction contract under General Requirements. However, if the Mortgagor pays for the policy, the insurance premium belongs under Insurance on Line G-55, Insurance, of Form HUD-92264.

- (2) Do not include salaries of owners, partners, or officers of the general contracting firm when they visit the site. This is included in General Overhead. The only exception would be actual work done on the job by these individuals in a trade capacity, as laborers or supervisors.

- b. General Overhead. Covers contractor's head office and general business expenses. Amount is fixed at 2 percent of the sum of Total Land Improvements, Total Structures, and General Requirements.
- c. Builder's Profit. Calculate as a percentage of the sum of Total Land Improvements, Total Structures, and General Requirements. Percentage amount is determined by the nature and location of the project.
 - (1) BSPRA. Builder's and Sponsor's Profit and Risk Allowance (BSPRA) applies to projects where there is an identity of interest between the mortgagor and the general contractor. BSPRA is limited to Section 220 and Section 221(d) (4) projects with such an identity of interest. The appraiser calculates the BSPRA amount and enters it on line G 68 of Form HUD-92264. Where BSPRA applies, do the following:
 - (a) Calculate an equivalent builder's profit and an equivalent subtotal.
 - (b) On the Builder's Profit line of Form HUD-92326 and on Line G 44 of Form HUD-92264, enter the word "BSPRA". The equivalent builder's profit calculated above is not included in the Total for All Improvements (bottom of Form HUD-92326 and Line G.50 of Form HUD-92264).
- d. Architect's Fees. Source is Owner-Architect Agreement, AIA Form B-108, to be provided to Lender's estimator. In the event of multiple prime contracts (e.g. engineers), total in line G 45 of HUD-92264 and itemize in Section O, Remarks. Estimator should copy the fee amounts, unaltered, to the cost estimate. Estimator should document architect's fees and compare with existing fee data to determine reasonableness. Estimator should inform the Lender if fees are significantly different from the data range, but the fees should not be altered on the cost estimate without a prior meeting between the Lender, Lender's estimator, mortgagor, and project Architect. Fees should be documented as a percentage of the sum of Total Land Improvements, Total Structures, General Requirements, General Overhead, and Builder's Profit (equivalent Profit in BSPRA cases).

The Architectural Design Fee covers preparation of all construction documents (working drawings and specifications) up to start of construction. (Usually 75 to 80 percent of total) And, the Architectural Supervision fee covers, covers the Architect's construction inspections, reports, and preparation of change order requests. (Usually 20 to 25 percent of total).

- e. Bond Premium covers Performance Bond, used to ensure completion of construction in event of a default by the general contractor. Bonding company determines applicable rate by the nature and location of the project and the contractor's history.
- f. Other Fees are costs of various required items and services. They can vary greatly from community to community. They can be paid either by the mortgagor or the general contractor. The mortgagor may submit an itemized list with costs as an aid to the cost estimator. The Other Fees can include:
 - (1) Site and topographic surveys,
 - (2) Subsurface exploration (test borings),
 - (3) Soil tests, concrete tests, and other construction testing.
 - (4) Fees for utility taps and connections.
 - (5) Building permits and licenses.
 - (6) General Contractor's cost certification audit fee (if required).

NOTE: The mortgagor's cost certification audit fee is not to be included in Other Fees since it is recorded separately on Line G. 66 of Form HUD-92264.

- 5. Construction Time. Measured in months. Varies depending upon size, complexity, location, and type of construction. Estimate construction time through examination of data. When documenting, it is recommended to establish graphs for each project type and structural system. Graphs should indicate the number of dwelling units and number of months to construct. Report construction time on Line G. 52 of Form HUD-92264.

D. Property Insurance Schedule and Requirements

- 1. The Property Insurance Schedule (Form HUD-92329) documents the 100 Percent Insurable Value of the project structure(s). See MAP Forms Book for HUD-92329 preparation instructions.
- 2. Property Insurance Requirements (Form FHA-2447) accompanies the Property Insurance Schedule. It is prepared by HUD and provided to the Lender at closing. It serves as an official advisory to the Lender of the Requirements of the Federal Housing Commissioner of the types of Property Insurance necessary to be maintained upon the property and of the estimate of the Total 100% Insurable Value of the property. See MAP Forms Book for an example of Form FHA-2447.

6.4

Project Processing – Pre-Application Stage

Performed by HUD. See Section 6.7 below.

6.5**Lender's Project Processing – Firm Stage**

At this stage, the Lender's cost estimator will prepare a detailed cost estimate and all required reports and recommendations indicated below:

A. Forms to Use

1. Form HUD-92326. Used for preparation of detailed construction cost estimate.
2. Form HUD-92331-B. Used to make detailed comparison of trade line items between Estimators' cost estimate (HUD-92326) and Contractor's trade payment breakdown (HUD-2328).
3. Form HUD-92329. Property Insurance Schedule, used to determine the Maximum Insurable Value for all project structures. Note that Form FHA-2447, Property Insurance Requirements, will be prepared by HUD and provided to the Lender at closing.
4. Form HUD-92264. Project Income Analysis and Appraisal.
 - a. Section G. Estimated Replacement Cost, Line 36a through 52, used to summarize Total Structures, Land Improvements, General Requirements, and Fees from Form HUD-92326. Also records Estimated Construction Time.
 - b. Section M. Used to summarize Cost Not Attributable to Dwelling Use (lines 10 through 15), and Offsite Requirements (lines 16 and 17).
 - c. Section O, Remarks. Used to explain Unusual Land Improvements, Other Fees, itemization of professional fees (e.g. engineers), overall difference between Lender's and mortgagor's cost estimates, and other cost items.

- B.** Prepare detailed cost estimate on Form HUD-92326 using instructions in Section 6.3. Sign form on the "Estimate Prepared by" line and certify. See standard certification in Chapter 11, Section 11.2. The Lender's architectural analyst will supply detailed plans and specifications as indicated in Chapter 5, Section 5.5.

- C.** Resolve differences in Lender's and contractor's construction cost estimates.

Before the Firm application can be submitted for HUD review, there must be a general agreement between the construction cost estimates prepared by the general contractor and the Lender's cost estimator. The Lender's cost estimator is responsible for resolving major differences between the two estimates. When the two estimates generally agree, the Lender may use the contractor's cost figures as shown on Form HUD-2328 as its cost estimate. The Lender's cost estimator will use the following review procedure:

1. Prepare trade line item comparison of Lender's and contractor's cost estimates using Form HUD-92331-B.
 - a. Enter costs from Form HUD-92326 and HUD-2328. For multiple-structure type projects, a separate HUD-2328 must be submitted for each structure type, and a master HUD-2328 for the entire project.
 - b. Calculate and list line item percentage differences.
2. Review trade line item differences and note all variations beyond normal ranges. The range of trade line item differences varies from trade to trade. Major trades (e.g. engineers, carpentry)

should have a smaller range difference than minor trades (e.g. sheet metal). The estimator should judge the variations based on established data.

Front-end Loading: The estimator should be alert for a pattern of front-end loading in trade items, where the contractor inflates the first few trade item costs in order to secure more mortgage proceeds early on in construction. Such a pattern may indicate inadequate working capital or risky business practices on the contractor's part. Front-end loading can jeopardize the construction of the project, especially since the contractor must underestimate later trades in order to balance out the bottom line of the estimate, making these later trades especially vulnerable to shoddy work practices and even outright default.

3. Meet with contractor to discuss and resolve all questionable trade line item differences. Resolution process may result in either the estimator or the contractor, or both, recalculating costs of various trade line items based on discussions.
 - a. If differences are resolved, accept costs in Form HUD-2328 and use as Lender's Cost Estimate in Form HUD-92264.
 - b. When dealing with suspected front-end loading, require rigorous documentation of early trade items that are higher than normal.
 - c. If differences cannot be resolved, do not accept costs in Form HUD-2328.
 - (1) Use estimator's cost estimate as Lender's cost estimate.
 - (2) Inform the Lender's underwriter that the contractor's HUD-2328 is unacceptable.
 - (3) Advise the Lender's underwriter to meet with the mortgagor and the contractor for further attempts at resolution.
- D. Prepare cost portions of Form HUD-92264, using instructions in Section 6.3. Sign form in the "Cost Processor" box and certify. See standard certification in Chapter 11, Section 11.2.
- E. Property insurance schedule, Form HUD-92329, provides a guide for the amount of insurance coverage. Note that Form FHA-2447, Property Insurance Requirements, will be prepared by HUD and provided to the Lender at closing. (See MAP Forms Book for HUD-92329 preparation instructions and an example of Form FHA-2447).
 1. Prepare form at submission of Firm Commitment package.
 2. Estimate 100 percent insurable value for each building.
 - a. Include cost of structures, foundations and basement, underground utilities within the building walls, and a proportionate share of allowances and fees, except for Other Fees.
 - b. Do not include the cost of land improvements, onsite demolition, or offsite work.
 - c. Include the cost of major mechanical equipment, such as boilers serving the entire project, in the cost of the building where the mechanical equipment is located.

- F. Prior approval of identity of interest subcontractors' amount including overhead and profit.
1. Identity of Interest is a relationship that exists giving the mortgagor or general contractor apparent control or influence over a subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing. (See General Contractor's cost certification instructions in Chapter 13 - Cost Certification, for definition of relationships).
 2. Requirements. When subcontractors, material suppliers, or equipment lessors have an identity of interest with a mortgagor or general contractor, the lender must approve the subcontract amounts, including specific amounts for subcontractor general overhead and profit.
 3. Timing. Approval is required before work begins under the subcontract. Failure to secure prior approval will result in the disallowance of the total general overhead and profit of the subcontractor at cost certification.
 4. Request for approval (with the subcontracts, agreements, or leases) goes to the Lender's cost estimator, whose recommendations must cover:
 - a. Acceptability of the documents.
 - b. Reasonableness of guaranteed maximum prices for the subcontract work.
 - c. Appropriateness of general overhead and profit dollar amounts.
 5. Mandatory Conditions for Approval. Note that the burden of proof is on the subcontractor.
 - a. Subcontracts:
 - (1) There must be a separate one for each trade.
 - (2) Subcontract must clearly identify scope of work.
 - (3) Be on a cost plus fixed fee basis:
 - (a) Guaranteed maximum dollar amount for work.
 - (b) Specific dollar amount for general overhead and profit.
 - (4) Disapprove "paper conduit" arrangements where work is to be done by general contractor personnel or other subcontractors, suppliers or lessors.
 - b. Subcontract prices: For this criterion, recent reliable data is a better test than whether higher bids were submitted.
 - (1) The total price must not exceed the amount shown for the trade item on the accepted Form HUD-2328.
 - (2) Total price must not exceed reasonable prices taken from available data.

NOTE: The Lender's cost analyst must resolve disagreements in trade prices with the subcontractor.
 - c. Overhead and Profit. The amounts for general overhead and profit shall be no higher than the typical prices for the specific trade.

- d. Subcontractor entity.
 - (1) The firm must operate and have documented experience as a subcontractor for the specific field covered in the subcontract.
 - (2) Must control labor, materials, and equipment typical for the trade.
 - (3) Must do significant business in its specific field with mortgagors and general contractors having no identity of interest.
6. If total of all identity of interest subcontracts, purchases and leases is less than $\frac{1}{2}$ of 1 percent of the mortgage amount, the requirements for each identity of interest subcontractor to cost certify may be waived by the Hub Director upon notification by the Lender.
7. Prepare letter of approval or disapproval to the mortgagor or general contractor. Letter must address all mandatory conditions.
 - a. Approval will indicate any conditions, including whether or not subcontractor must cost certify.
 - b. Disapproval will state the reason for disapproval and indicate any cost certification requirements.

6.6

Lender's Processing – Substantial Rehabilitation

- A. General. In developing the cost estimate for substantial rehabilitation, follow the instructions of other sections of this chapter, except as modified by the following:
- B. Firm Stage:
 1. Rehabilitation cost estimate:
 - a. Mortgagor's Cost Exhibits. Detailed plans, specifications, and scope of rehabilitation work supplied by Lender's architectural analyst as indicated in Chapter 5, Sections 5.5 and 5.14, and general contractor's Form HUD-2328.
 - b. Lender's cost estimator will do the following:
 - (1) Using the construction drawings and specifications, the scope of work indicated in the joint work write-up and applicable data (all supplied by the Lender's architectural analyst), the Lender's cost estimator will prepare a detailed cost estimate. Estimate must include quantities and unit costs for all items described in the joint work write-up. Include the following items that are specific to substantial rehabilitation:
 - (a) Interior demolition and removal of floors, walls, roofs, doors and windows, finishes, cabinets, appliances, plumbing, HVAC, and electrical, including boilers and central air conditioning. Also includes abatement of asbestos and lead based paint. Enter amount in Special Construction trade line in Form

HUD-92326. If individual trades include removal (e.g. remove and replace cabinets), removal costs may be included in the trade line item.

- (b) Onsite demolition is not part of the Construction Contract and should be estimated and recorded in the same way as for new construction. See Section 6.3.
- (c) Allowances and Fees for substantial rehabilitation, especially General Requirements and Architect's Fees, are calculated the same way as for new construction, but they should reflect the risk and responsibility inherent in rehabilitation and consider the location of the project. Recommend that the cost estimator keep separate data for this item.
- (d) Rehabilitation time is determined the same way as construction time for new construction, but the data used must take into account the time required for interior demolition, as repair and rehabilitation cannot begin until such demolition is complete.
- (e) Rehabilitation cost not attributable to dwelling use includes an "as-is" value for non-attributable items in addition to a value for actual work performed. Calculate by using the format in the Appendix 6C. The cost analyst completes steps 1, 2, and 3, steps 4 through 8 are completed by the appraiser.
- (f) Contingency reserve amount is based on available data for the type and condition of structure. Calculate as percentage of the sum of structures, land improvements, and general requirements. Percentage ranges from 10 to 15 percent, depending on the condition of the project, extent of rehabilitation, and experience and financial capacity of the mortgagor and contractor. Enter amount on line G.71 and in Section O of form HUD-92264. The Borrower may elect to apply any funds remaining in the substantial rehabilitation construction contingency account after completion of the approved rehabilitation, to:
 - a. further improvements, betterments or upgrades to the property, or
 - b. reducing the mortgage balance.

If excess funds from contingency are used for betterments, those additional improvements will not be considered as the basis for a request for an increased mortgage amount.

2. Annual Deposit to Replacement Reserve. Because the rehabilitation work will result in a structure which will require no complete replacement of doors, windows, roofs, cabinets, or mechanical/conveyance systems for at least five years (see Chapter 5, Section 5.17), there is no initial deposit to the Reserve for Replacements for substantial rehabilitation. The cost analyst will work with the appraiser to determine the Annual Deposit to the Reserve for Replacement (ADRR). Monthly deposits to the Reserve for Replacement commence in accordance with the FHA Commitment. Calculations for the ADRR must be reviewed and appropriately revised every 10 years.

A. New Construction. No detailed cost estimate is done at this stage. Cost estimation is limited to a review of the bottom line amount for Main Buildings on the mortgagor's application, Form HUD-92013. HUD cost estimator will perform the review as follows:

1. The Lender will submit the Architect's sketch plans for the project at this stage.
2. Using the sketches, the cost analyst will determine the structure type and calculate the project's gross floor area.
3. Using construction cost data the cost analyst will calculate an estimated Total Structures cost for the project's structure type and gross floor area.
4. The cost analyst:
 - a. Will compare the estimated Total Structures cost with the mortgagor's amount for Main Buildings on Line 4 of Section G of Form HUD-92013, and will calculate a percentage difference between the two amounts;
 - b. Will examine Total Land Improvements, General Requirements, Builder's Profit, Architectural Fees, Bond Premium, and Other Fees for reasonableness in comparison with established data.
 - c. If the percentage difference is acceptable, accept the mortgagor's cost.
 - d. If the percentage difference is in a questionable range, attempt to reconcile the percentage difference with the mortgagor to bring the mortgagor's figure into an acceptable range, or
 - e. If the percentage difference is un-reconcilable, indicate in the review report that the project is infeasible.
 - f. Prepare a review report (Appendix 6A.1) containing cost findings and submit to Team Leader.

B. Substantial rehabilitation.

1. Mortgagor's Cost Exhibits: Sketch plans and basic work write-up for rehabilitation work supplied by mortgagor's Architect as indicated in Chapter 5, Section 5.16, and mortgagor's summary cost estimate for proposed rehabilitation. Note that a bottom line estimate is only acceptable for complete (gut) rehabilitation at this stage. For projects involving partial rehabilitation, the mortgagor's Architect must provide enough detail in the basic work write-up to establish a clear scope of work. The extent of rehabilitation work should be expressed in percentages. (Example: Remove and replace 20 percent of subfloor, 50 percent of kitchen cabinets, 25 percent of sinks and bathtubs, etc.). An itemized trade line item cost estimate is not required at this stage, but major trade groups, such as trowel trades (concrete, masonry), hammer trades (carpentry, drywall, insulation), and mechanical trades (plumbing, heating, electrical) should be separated.
2. HUD summary cost estimate of rehabilitation work: The cost estimator will do the following:
 - a. Review the Lender's exhibits.

- b. Using available cost data develop a summary cost estimate of rehabilitation work. The estimate will summarize rehabilitation costs for all main buildings, land improvement costs, and allowances and fees.
- c. Compare the HUD and mortgagor's cost estimates and report significant differences.
- d. Discuss differences with Lender in order to resolve.
- e. Prepare report (Appendix 6A.1) with recommendations:

- (1) If significant differences are resolved, accept the Lender's cost.

- (2) If the differences are un-reconcilable, advise the Team Leader that the project is infeasible.

6.8

HUD Procedures for Firm Stage

- A. Lender will submit:
 1. Lender's completed cost package including the detailed cost estimate and the property insurance schedule.
 2. Mortgagor's cost document package consisting of completed contractor's cost breakdown on form HUD-2328, detailed plans and book specifications. For substantial rehabilitation, include useful life estimate of replacement reserve components (if applicable).
- B. The HUD cost analyst will examine the Lender's cost estimate, the underwriting summary and the cost exhibits. The HUD analyst will review the quality of the Lender's estimate and the transaction itself. The HUD analyst will not reprocess the case. However, if the HUD analyst determines that certain underwriting conclusions are not supportable and affect HUD's risk, the analyst may recommend that the Lender modify the application or recommend a rejection. The Team Leader will approve, reject or modify the recommendation of the HUD cost analyst.
- C. HUD cost analyst will review the lender and mortgagor packages and will recommend either acceptance or rejection of the cost portion of the firm submission. Architectural exhibits, including construction documents, will be used as backup. HUD cost recommendations will be based on:
 1. Comparison of Lender's estimate and contractor's HUD-2328 cost breakdown with HUD cost data. Comparison will include:
 - a. Bottom line figures for total structures and land improvements and figures for allowances and fees;
 - b. Cost Not Attributable;
 - c. Examination of lender-contractor variance report prepared by Lender's cost estimator, indicating resolution of cost differences.
 2. Examination of identity of interest relationships and applications for identity of interest subcontractor overhead and profit.

3. Property insurance schedule.
- D. HUD cost analyst will issue a written report (Format in Appendix 6A.2) containing recommendations and forward a copy to the HUD team leader.
- E. Signatures. The Lender's cost analyst must sign and date Form HUD-2328 in the FHA: Processing Analyst box. The Lender's Underwriter must sign and date Form HUD-2328 in the FHA: (Chief, Cost Branch or Cost Analyst) box. The FHA (Chief Underwriter) line will be endorsed by both the HUD cost reviewer and the HUD Team Leader.

6.9**Section 223(f) - Lender Responsibilities and Deliverables****A. Responsibilities**

1. The Lender prepares the Project Capital Needs Assessment (PCNA) and Replacement Reserve Escrow in accordance with Appendix 5M. The Lender's responsibilities are to:
 - a. Prepare a Physical Inspection Report (PIR) containing an estimated cost, adjusted for inflation, to complete the projects:
 - (1) Immediate repair needs; and
 - (2) Expected repair, replacement, and major maintenance needs over a specified time period such as ten years.
 - b. Prepare a Statement of Resources and Needs which:
 - (1) Identifies:
 - (a) All critical repairs which must be completed before initial/final endorsement and the associated cost of doing the work.
 - (b) Non-critical repairs to be completed after final endorsement and the associated cost to be escrowed.
 - (2) Recommends:
 - (a) The amount of:
 - (i) The initial deposit to the replacement reserve, if any;
 - (ii) The monthly deposit to the replacement reserve
2. The Lender's cost analyst's responsibilities are to:

- a. Perform an independent review of repair costs contained in the PCNA. The Lender must conduct an independent cost review of the PCNA report. Neither the individual who inspected the property and prepared the PCNA (the Needs Assessor – see Appendix 5M), nor the firm that employed the Needs Assessor, is eligible to review the costs in the PCNA report. The Lender must use an independent third party to review the PCNA report.
- b. Complete the cost portions of Form HUD-92264, Project Income Analysis and Appraisal, regarding “as new” replacement cost. *

*NOTE: The Lender’s appraiser works with the cost analyst to determine the “as new” replacement cost estimate and will enter the figures in Section G, lines G.36 through G.50 of Form HUD-92264.

- c. Prepare Form HUD-92329, Property Insurance Schedule. Note that Form FHA-2447, Property Insurance Requirements, will be prepared by HUD and provided to the Lender at closing. (See MAP Forms Book).

B. Deliverables at Firm Stage

1. Project Capital Needs Assessment containing estimates of critical and non-critical repair costs and the initial and monthly deposits to the replacement reserve.

NOTE: The Lender’s appraiser works with the cost analyst to determine the “as new” replacement cost estimate and will enter the figures in Section G, lines G.36 through G.50 of Form HUD-92264.

2. Independent Lender review of repair costs in PCNA.
3. Preparation of Form HUD-92329, Property Insurance Schedule. Note that Form FHA-2447, Property Insurance Requirements, will be prepared by HUD and provided to the Lender at closing. (See MAP Forms Book).

6.9.1

Lender Project Processing – Firm Stage

The Lender’s cost estimator will prepare all required reports and recommendations indicated below:

A. Forms to Use

1. Form HUD-92264
 - a. Section G, Estimated Replacement Cost, Lines 36 through 50. Replacement cost figures are determined by the Lender's cost analyst and appraiser and entered by the Lender’s appraiser.
 - b. Section O, Remarks. When Lender review of PCNA is complete, the Lender’s cost analyst will record totals for Project Repair costs and Initial Deposit to Replacement Reserve taken from PCNA.

2. Form HUD-92329, Property Insurance Schedule, used to determine the Maximum Insurable Value for all project structure based on Lender's appraiser's estimate of value after repairs.
- B. There is no Cost Not Attributable for projects insured pursuant to Section 223(f).
- C. Property Insurance Schedule, Form HUD-92329, provides a guide for the amount of insurance coverage. See MAP Forms Book for preparation instructions.
1. Prepare form at submission of Firm Commitment package.
 2. Using estimate of value after repairs supplied by the Lender's appraiser, estimate 100 percent insurable value for each building.
 - a. Value is of structures only. It does not include land value.
 - b. Do not include the cost of land improvements, onsite demolition, or offsite work.
 - c. Include the cost of major mechanical equipment, such as boilers serving the entire project, in the cost of the building where the mechanical equipment is located.

6.9.2**HUD Procedures for Firm Stage**

- A. Lender will submit a completed cost package including:
1. Cost estimates for repairs and Replacement Reserve deposits contained in the PCNA (prepared by Lender's Needs Assessor);
 2. Independent Lender cost review of PCNA;
 3. Summary Replacement Cost Estimate;
 4. Property Insurance Schedule.
- B. HUD cost analyst will review Lender exhibits and will recommend either acceptance or rejection of the Cost portion of the Firm submission. HUD cost recommendations will be based on review of:
1. Repair estimate based on the PCNA and compared with HUD data.
 2. Lender's estimate for Initial Deposit to Replacement Reserve contained in the PCNA and compared with HUD data.
 3. Property Insurance Schedule.
 4. Any information produced by the Lender's architectural analyst which may affect cost.
- C. HUD Cost Analyst will issue a written report (Format in Appendix 6-A) containing recommendations and forward a copy to the HUD Team Leader.

CHAPTER 7

SUMMARY OF MAJOR CHANGES IN CHAPTER 7 OF THE MAP GUIDE

Valuation Analysis & Market Study Requirements

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site:

<http://www.hud.gov/offices/hsg/hsgmulti.cfm>.

The revision to Chapter 7 was a major re-write that provides more specific direction. A description of each section follows:

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- | | |
|-----|---|
| 7.1 | Purpose of Valuation Analysis
Self Explanatory - No Changes |
| 7.2 | Selection of Appraisers and Market Analysts
Self Explanatory - Requirements were added that the underwriter shall not act as the appraiser or market analyst, and that in the selection of an appraiser, there shall be no discrimination on the basis of race, color, national origin, religion, sex, age, or disability. The lender may assist in the preparation of appraisal forms. |
| 7.3 | Appraiser and Market Analyst Qualifications
Self Explanatory - Additional instructions were added regarding temporary certifications. |
| 7.4 | Market Study Requirements
New Effective Date Requirement - For pre-applications, the effective date of the study must be within 120 days before the date the pre-application package is delivered by the Lender to HUD. For Firm Commitments, the effective date must be within 180 days prior to the issuance, re-issuance or amendment of the Firm Commitment. |
| 7.5 | Guide for Content and Format of a Market Study for General Occupancy Rental Housing
Was formerly in the Appendix. This is a major re-write and requires careful review. |
| 7.6 | Appraisal Requirements
Self Explanatory - This section is a major re-write that addresses updated USPAP requirements, acceptable appraisal methodology, estimates of remaining economic life and requirements regarding the appraiser's inspection of the subject. New effective date requirements- similar to Market Study |
| 7.7 | Estimated Project Income |

Was formerly “Estimated Rental Income.” This section provides guidance on estimating the rental income as well as other project income. There is also guidance regarding developments for the elderly by referring to Chapter 3.5.

7.8 Operating Expense Estimates

This section provides guidance on estimating operating expenses. Guidance was added on the selection of expense comparable and confidential data. A large subsection was added to provide specific instructions on updating expense estimates. Also, instruction on the calculation of the Replacement for Reserves was relocated here.

7.9 Site Analysis

This section provides instructions on assessing the suitability and marketability of the project site and determining its value. Guidance was added on site value for subsidized and/or Low Income Housing Tax Credit (LIHTC) applications.

7.10 Pre-Application Stage for Sections 220, 221(d) & 231 (New Construction Only)

Self Explanatory - No major changes except for the addition of Section 231 (new construction only)

7.11 Firm Commitment Processing for Section, 220, 221(d) & 231 (New Construction Only)

Self Explanatory - Section 231 (new construction only) was added. There were also additional details added regarding the completion of the form HUD 92264, specifically on remaining economic life and interest during construction.

7.12 Firm Commitment Processing for Section 223(f)

Self Explanatory – Changes in R for R per HN2010-11 were made.

7.13 Substantial Rehabilitation Processing for Sections 220, 221(d)(3) & 221(d)(4)

Self Explanatory – The instructions on Developer’s Fee from Notice H 96-63 were incorporated into this section along with a discussion on what items are no longer included in the Estimated Replacement Cost of a Project. There are also instructions on processing substantial rehab for Section 231

7.14 Calculating Operating Deficits

Self Explanatory - No major changes.

7.15 Ground Leases

Self Explanatory - No major changes.

7.16 Tax Abatement/Exception

Self Explanatory - No major changes, except that we more clearly state that no value may be attributed to short term tax abatement.

7.17 Section 8 and LIHTC Processing

This is a new section that also includes instructions on Income Limits pursuant to The Housing Economic Recovery Act of 2008 (HERA).

Chapter 7

Valuation Analysis & Market Study Requirements

7.1

Purpose of the Valuation Analysis

- A. The Valuation Analysis is completed for the purpose of evaluating the existing or proposed property as security for a long-term HUD-insured mortgage. Included in this analysis, depending on program requirements, is an estimation of the market value or investment value of the property and an analysis of the market need, location, earning capacity, operating expenses, and warranted cost of the property.
- B. The Valuation Analysis develops conclusions with respect to feasibility, suitability of improvements, extent, quality, and duration of earning capacity and other factors that have a bearing on the economic soundness of the property. The objective is to have a properly designed project in the right location, capable of supporting the loan. Such a project meets the demands of the rental market at rents that will pay all expenses of operation, debt service, and return to equity where such return is permitted.

7.2

Selection of Appraisers and Market Analysts

The MAP Lender is fully responsible for the selection, approval, and training (if needed) of appraisers and market analysts who are familiar with HUD reviews and guidelines. Lenders must ensure that each appraiser and market analyst selected is qualified to appraise or perform market analyses for multifamily properties by reviewing their education, quality, and frequency of multifamily appraisal experience, sample appraisals and market studies, professional affiliations, and state licenses or certifications. It should be noted that the ability to complete various HUD forms related to the appraisal, ie. HUD-92264, 92264A,, etc., is not a requirement. The lender may assist the appraiser in the preparation of these forms. However, the appraiser must sign them unless he/she is not in agreement with value conclusions contained on the forms.

- A. Should the MAP Lender have difficulty finding a Certified General Appraiser, the Appraisal Subcommittee of the Federal Financial Institutions Examination Council maintains a national registry of Certified General Appraisers who are authorized, under Federal law, to perform Appraisals in connection with federally related transactions. The MAP Lender would be able to review this list on the Internet at <http://www.asc.gov>. However, inclusion on this list is not an indication of competency to perform multifamily appraisals.
- B. The appraiser or the market analyst may not be affiliated with any individual or institution involved in the application other than the MAP Lender. Appraisers or market analysts who are on the Lender's staff must be independent of the lending, investment, and collection functions of the Lender. The underwriter shall not act as the appraiser or market analyst.
- C. In the selection of an appraiser or market analyst, there shall be no discrimination on the basis of race, color, national origin, religion, sex, age, or disability.

- D. The Department reserves the right to examine the credentials of all appraisers and market analysts hired by the Lender, and to reject any and all individuals that it considers unqualified.

7.3

Appraiser and Market Analyst Qualifications

A. Each appraiser must meet the following minimum qualification requirements:

1. Be a Certified General Appraiser under the appraiser certification requirements of the State in which the subject property is located;
2. Be currently active and regularly engaged in the appraisal of multifamily properties;
3. Meet all requirements of the Competency Rule described in Uniform Standards of Professional Appraisal Practice (USPAP), this applies to each certified appraiser who signs the report. If any of the persons involved in preparing the report is a trainee acting as an assistant only, this must be disclosed to the processing center;
4. Have at least three years of income property appraisal experience;
5. Be knowledgeable concerning current real estate market conditions and financing trends in the geographic market area where the subject property is located, and
6. Be experienced in appraising multifamily properties with the complexity and characteristics similar to those of the subject property. If the subject property contains commercial space, the appraiser must have experience in the appraisal of commercial properties.

These requirements apply to EACH certified general appraiser signing the report. It is not permissible for an appraiser who is not certified in the appropriate jurisdiction to circumvent certification requirements by having a locally certified appraiser co-sign the report. Appraisers who are not certified in the appropriate jurisdiction may not perform the MAP required property inspections of the subject or comparable properties. If any of the persons involved in preparing the report are not certified general appraisers and are acting as an analyst, assistant or trainee, this must be disclosed to the HUD Office.

B. Temporary Certification. Temporary certifications are permissible; however, competency requirements as defined above still apply. The appraiser is responsible for checking the accuracy of all information obtained from local sources and must indicate the names of all individuals who provided material assistance in preparing the appraisal. The temporary certification must be obtained prior to beginning the assignment. The processing center may approve appraisers who have temporary certification who have documented how they will achieve competence in the subject's market area in accordance with USPAP.

C. Each Market Analyst must meet the following minimum qualification requirements:

1. Have at least three years of experience in performing market analysis for income producing property,
2. Be currently active and regularly engaged in performing market studies for multifamily properties,
3. Be knowledgeable concerning real estate market conditions and financing trends in the geographic market area where the property is located, and
4. Be experienced in performing market studies for multifamily properties with the complexity and characteristics similar to those of the subject property. If the subject property contains

commercial space, the analyst must have experience in the completing market studies on commercial properties.

- D. If the HUD processing center believes that a lender is contracting unqualified or unlicensed professionals, they must refer the specifics of the case to the Lender Qualifications and Monitoring Division in Headquarters.

7.4

Market Study Applicability/Requirements

- A. **Applicability.** For all new construction properties and all substantial rehabilitation projects with significant tenant displacement, the appraisal and market study should be completed by different entities. This requirement includes tax credit transactions with economic rents, which do not have project based rental assistance. The Hub Director can waive this requirement on a case-by-case basis, if it is clear the appraiser or appraisal firm is capable of performing both the appraisal analysis and a macro-economic market analysis, and if the strength of the market is not in question. Section 223(f) proposals typically do not require a market study separate from that contained in the appraisal, however in volatile or declining markets, the Lender should consider and may be required to obtain such a study to support the underwriting conclusions of market demand for the subject property over the loan term. Market studies are not required for properties with at least 90% of units covered by a rental assistance contract and no rent increase.
- B. **Requirements.** Each market study must meet the following requirements:
1. Be prepared for the Lender and paid for and initiated by the Lender. A market study that has already been prepared for the borrower by a third party market analyst and meets all other market study elements as stated in the MAP Guide is acceptable. The Lender is fully responsible for the review of all market studies submitted to the Department.
 2. Meet the content and format requirements contained in Chapter 7.5.
 3. **Effective Date.** For pre-applications, the effective date of the study must be within 120 days before the date the pre-application package is delivered by the Lender to HUD. For Firm Commitments, the effective date must be within 180 days prior to the issuance, re-issuance or amendment of the Firm Commitment. Expired reports must be updated as needed by re-surveying all relevant data.
 4. Be prepared with the list of information supplied by the MAP Lender described in Appendix 4.
 5. Be prepared in conformance to the market study format found in Chapter 7.5, "Guide for Content and Format of a Market Analysis for General Occupancy Rental Housing—Section 220, 221(d)(iii) & (iv), 231 Programs."
 6. In cases where the appraiser prepares the market study, it must be submitted as an independent exhibit.
 7. Include market analyst's certification. See certification format in Chapter 11 of MAP Guide.
 8. The market analyst may not consider, analyze, or report any information that makes reference to race, color, sex, handicap, familial status, religion, or national origin of the geographic area, neighborhood, occupants, owners or prospective owners. HUD will reject any Firm

Commitment application for mortgage insurance that considers any of these issues in the preparation of a market study.

7.5

Guide for Content and Format of a Market Study for General Occupancy Rental Housing

A. Purpose and focus of the study. The purpose of the housing market study is to assure that there is enough sustainable demand for additional units without adversely impacting the existing supply (maintaining a balanced overall market). The focus of the market study is on the overall demand within a Housing Market Area (HMA), and also the marketability of the proposed project to capture a share of the total or incremental demand. The study must estimate the number of renter households with sufficient incomes to afford the type of housing at the rents proposed. In addition, the study must estimate the number of units that the market could reasonably absorb over a specified forecast period, typically three years, taking into consideration competitive units in the existing inventory, units currently under construction, and units in the planning pipeline, as well as the gross and contract rents of those units.

For age restricted projects, the study must estimate the number of elderly households with sufficient incomes to afford the type of housing and services under study; the proportion of those income-affordable elderly households that would "need" such housing and services; and the number of units that the market could reasonably absorb over the forecast period.

B. Executive Summary. All market studies shall contain an Executive Summary with a concise summary of the data, analyses and conclusions, including the following:

1. a concise description of the site and the immediate surrounding area;
2. a brief summary of the project, including the proposed targeted population;
3. a precise statement of key conclusions reached by the analyst;
4. a concise statement of the analyst's opinion of market feasibility, as determined by factors of market demand;
5. recommendations and/or suggested modifications to the proposed project, if appropriate;
6. a summary of competitive advantages and disadvantages, and issues that will affect the property's marketability, performance and lease-up, as well as points that will mitigate or reduce any negative attributes.

C. Description of the proposed project. The market study must include a thorough description of the proposed project, including:

1. The number of units by type and size. Include information on the number of bedrooms, number of bathrooms, structure type, square footage, etc. Actual (paint to

paint) size should be noted as well as the published size, as in how the project will be portrayed in brochures or other media.

2. The lender's proposed market rents and gross rents by unit type. (Gross rent is defined as the cost of renting the unit, including the cost of tenant paid utilities.)
3. The unit and project amenities and services.
4. The project location in terms of:
 - a. Characteristics of the neighborhood in relation to schools, transportation, shopping, employment centers, social and community services, etc., to include an study of the adequacy of the public facilities that will service the site. The report must include a map showing the site and important neighborhood facilities and amenities.
 - b. Any other location considerations relevant to the market and marketability of the proposed project.
5. Description of income or rent restrictions imposed on the project by the use of public financing and/or subsidies (e.g., low income housing tax credits, tax-exempt bonds or HOME funds).

Note: The report must address, in sections E. and G., how these income and rent restrictions will affect potential demand absorption and long term stabilized occupancy of the income-restricted units. (See 7.5.D.6 for further guidance.)

6. Description of characteristics of the proposal that will have a specific bearing on its market prospects and overall marketability, such as amenities, features, or design.
7. For Age Restricted Projects.
 - a. The estimated total monthly fees for shelter and optional services per resident by type of occupancy or accommodation.
 - b. The estimated total monthly fees for optional services provided on an as needed per resident basis.
 - c. The proportions of the project to be occupied by market rate tenants and by public pay/assisted residents-tenants, e.g. Optional State Supplement.
 - d. The amenities and special services provided by this type of housing and how they relate to the physical, mental, or social conditions of the prospective tenants.
 - e. Project location in terms of proximity to facilities and services essential to the tenants such as hospitals, medical/health care facilities, social and community services, public transportation, shopping and recreational activities; and any other location considerations relevant to the market or marketability of the

proposed project. Include a map showing the site and important facilities and services.

D. Definition of the Housing Market Area (HMA). For the purposes of HUD/FHA housing market study, a HMA is defined as the geographic area in which units of similar characteristics; number of bedrooms and rents, are in equal competition. This entails a discussion of where the competing projects are and where the majority of the tenants will come from. Current available evidence indicates that the size of the HMAs for general occupancy rental housing can vary significantly depending on the extent and location of comparable and competitive products within a specific area; but generally lies within commuting distance from a major economic center. Therefore, when defining the boundary of a market area, the analyst should consider the locations of comparable and competitive rental developments (existing, under construction and in planning-developments) and commuting times from major concentrations of employment. Study of data on place of work and place of residence of the population from the 2000 and 2010 (once available) Decennial Census, American Community Survey (ACS) and local sources will aid in this determination. The market study must include the following:

1. A map of the HMA, showing delineated boundaries, location of the subject, major highways and thoroughfares, geographic features like rivers and lakes, and political divisions like state lines and city limits. The map must have a title, bar scale, north arrow, and legend.
2. A description of the geographic boundaries of the housing market area and a justification for the delineation, including a discussion of the location of competitive housing, relevant services and amenities and concentrations of employment opportunities.
3. A description of the qualitative sub-market for the type of housing proposed, defining the economic and demographic characteristics of the target market (projected residents) in terms of income levels, household size, and age of prospective tenants.
4. A statement of the length of the specified forecast period, typically 36-48 months from the current date of the study.
5. For Age Restricted Projects.
 - a. the locations of the prior residences of the current occupants in comparable and competitive existing projects;
 - b. location and access to relevant services and amenities;
 - c. any concentrations of elderly population.
 - d. a description of the qualitative sub-market for the type of housing and care proposed by the economic and demographic characteristics of the target market (projected residents): income levels, wealth and assets, household size, age of prospective tenants, physical and/or mental limitations,

homeownership rates, and other similar factors;

- e. description of the Current Inventory; quantitative and qualitative characteristics of projects in the market area; occupancy rates and waiting lists;
 - f. total monthly charges by unit type, including the monetary level of concessions, type of accommodation, and level of services;
 - g. typical types of services and amenities offered, whether these are mandatory or optional fee for services, and whether services are provided by the facility (directly or by contract) or through a third-party arrangement (tenant-resident and provider and any added costs for optional services; and
 - h. absorption experience of recently completed projects on a units per month basis, discussing the level and extent of pre-sale or pre-marketing efforts.
6. For Income Restricted Projects. Provide an estimate of demand including a capture rate, based on potential income eligible tenants. An income eligible tenant is a tenant whose income does not exceed the maximum to be eligible for a tax credit rent, but sufficient enough to pay the tax credit rent without being overburdened. To make these determinations, it is essential to consider the following information and guidance:
- a. The calculation of the maximum affordable monthly rents for tax credit units is based on tenants paying at least 30 percent of income for rent. Experience has shown that few households in tax credit projects spend more than 50 percent of income for rent, meaning, if rents are set at the maximum, the potential market is restricted to income-eligible households with incomes between 75 and 100 percent of the respective income limit. Most households with incomes lower than this would be unable to afford the statutory maximum rents. Therefore, when the proposed rents are set at the statutory maximums, the market for a tax credit assisted project is comprised of a relatively narrow band of income eligible renters, which can result in a problem with the market feasibility of the project. Depending on the rental market conditions in the HMA, there may be an insufficient number of potential renters that meet the income limit criteria and who are also willing and able to pay the maximum allowable rent. The available information on tax credit assisted-units shows that most projects have established rents below the maximum permitted by the statute. In addition, many projects have some other form of assistance to further reduce rents, and this expands the number of income eligible tenants.
 - b. The determination of demand and the capture rate should take into consideration:
 - (1) the current and anticipated supply/demand conditions in the overall rental market,

- (2) the potential depth of the market of income eligible households in comparison to the number of units at the proposed rents,
 - (3) and the marketability of the proposed units taking into account the project's amenities, rents and location relative to comparable and competitive projects and other options available to those income eligible households.
- c. Capture Rate is defined as the percentage of households in the HMA that meet any applicable age and size restrictions and are within the income eligible band (meaning that incomes are low enough to qualify for the tax credit rent, but still high enough to pay the tax credit rent without being overburdened), that the property must capture to fill the units at the projected absorption rate and achieve stabilized occupancy. The Capture Rate is calculated by dividing the total number of units at the property by the total number of house holds that meet the applicable age, size eligible income band requirements.

NOTE: The processing office (PO) should consult with EMAD in assessing the determination of eligible income band and capture rate contained in the market study. If the PO finds that there is insufficient demand for the units at the proposed rents the PO should consult with the lender and require that the rents be lowered as necessary to broaden the band enough to ensure adequate absorption and achieve stabilized occupancy. If agreement cannot be reached on the appropriate rent levels, the project shall be deemed to be not feasible.

E. General characteristics of the HMA. The market study must include a thorough description of the current and forecast economic and demographic characteristics and conditions of the housing market area. The description is necessary to provide background and justification for the subsequent estimates of demand for additional rental housing. The study must include the following:

1. A discussion of current economic conditions and employment characteristics, including:
 - a. Identification of growth sectors in the economy and emerging trends. This should include a detailed discussion of the sectors in the economy that have a major impact on the local housing market such as, but not limited to military facilities, colleges and universities, federal and state government, or tourism.
 - b. An study of recent trends in employment; both unemployment statistics and at place employment, with a detailed discussion of:
 - (1) Any anticipated changes in at place employment as a result of expected closings, openings, expansions or cutbacks by leading employers, with a particular emphasis on how this would affect the rental market during the forecast period.
 - (2) Information on the types of new jobs being created and lost, including

data on pay scales and how these wage levels relate to the affordability of the proposed rental units.

- (3) List major employers in the HMA, the type of business and the number employed.
- (4) In relevant markets (such as resort areas), comment on the availability of affordable housing for employees of businesses and industries that draw from the HMA.

c. A forecast of employment for the specified forecast period and how this forecast supports demand for additional new rental housing.

2. A thorough discussion of past and anticipated trends in the demographic character of the housing market, covering such subjects as population change, migration, net natural change, household growth or decline, changes in the average household size, and changes in tenure. The report must include estimates of the total population and households (by tenure - owners and renters) that include the current date of the study, and the forecast date (three or four years from the date of the market study); and, a detailed explanation of all significant trends and changes.
3. Income Restricted Projects. Provide a discussion of current trends in the development of other income-restricted projects, while keeping in mind the eligible income band. (See 7.5.D.6) Particular attention must be given to existing, under construction and proposed projects that would require an eligible income band that is similar to the subject.

F. Current housing market conditions. The written market study report must include a comprehensive description of the current conditions of the rental market, and the sales market if relevant, in the housing market area. This description should include a direct summary statement on the current condition of the rental market overall and of the rent levels of the market comparable to the proposed project; as well as the following:

1. An estimate of the current competitive rental inventory, single-family and multifamily, in the housing market area, with data on the number of units by structure type, by number of bedrooms, by rent levels, age, and location.
2. A thorough discussion of recent market experience which presents and analyzes the following:
 - a. Current occupancy levels and recent trends in occupancy/vacancy in existing rental projects.
 - b. Absorption experience of recently completed rental developments, including estimates at a project level of per unit per month absorption rates, with particular emphasis on comparable and competitive projects that have entered the market within the past 24 months. When available, annual absorption from the past 10 years should be provided.

- c. Current shelter and gross rents for comparable and competitive projects, and the trend in rent increases in this inventory during the past 24 to 36 months. The description should identify any services included in base rents or offered at a premium. Where relevant, the report should include information on the extent of rent concessions or similar incentives, particularly in projects in initial occupancy. The report must address the impact of concessions on rent levels and whether the quoted rents are overstated due to concessions or other factors.
- d. Estimated current overall rental vacancy rate, overall apartment vacancy rate, and vacancy rate for units similar to those in the proposed project. Significant seasonal variations in vacancy rates, if applicable, should be discussed.
- e. Discussion of any vacancy or absorption problems in the market, particularly in the segments of the market most relevant to the subject project, including a study of the cause if the rates are significantly higher or lower than the overall rental vacancy rate.

3. The report must include a map showing locations of existing competing rental projects, projects currently under construction, and those in the planning and development process.

G. Characteristics of Rental Units in the Pipeline - Under Construction and in Planning. The written market study report must include separate estimates of the numbers of rental units currently under construction and the numbers in the planning and development process likely to enter the housing market during the specified forecast period. These estimates should include all rental developments known, not solely those determined by the analyst to be comparable and competitive. The description of the pipeline activity should clearly identify any significant characteristics of specific developments regarding rent restrictions or financing limits such as low-income housing tax credit financing or age-restricted occupancy. The report should contain estimates of:

1. The number of projects currently under construction, the total number of units, the numbers by bedroom size (number of bedrooms) by rent range, structure type and their locations.
2. The number of projects in planning stages that are likely to be developed, including but not limited to those with building permits or firm financial commitments, including details on the number of units by bedroom size, rents, locations, and stage of development.
3. Include a list of LIHTC projects with allocations in or near the market area that are not yet placed in service, giving as much known detail as possible on estimated placed-in-service dates, unit mix and income levels to be served.
4. For Age Restricted Projects.

- a. Total monthly charges by unit type, type of accommodation, and level of services. Provide information on the added costs for optional services.
- b. Typical types of services and amenities offered, whether these are mandatory or optional fee for services, and whether services are provided by the facility (directly or by contract) or through a third-party arrangement (tenant and care provider).

H. Demand Estimate and Study. The written market study report must include an estimate of future demand for the specified forecast period, typically 36 to 48 months. The estimate of demand and the study supporting that estimate must be consistent with the following guidelines:

1. The estimate of demand must be based on a calculation of incremental demand. This estimate must address the following factors:
 - a. Renter household growth during the forecast period.
 - b. Recent trends in tenure breakdown between homeownership and renting that may increase/decrease the demand for rental units.
 - c. Replacement of existing rentals lost from the inventory due to demolition, conversion, shifting owner units into the rental market, and other means; and consideration of any current excess vacant supply based on a balanced market vacancy rate. The demand estimate must reflect the number of rental units that, if added to the inventory, would promote balanced market conditions.
2. The estimate of demand should be broken down into a qualitative estimate of demand by number of units by bedroom size, rent range, and other relevant characteristics, as necessary.
3. The demand estimate should identify the "effective demand" pool of households with sufficient incomes and or the applicable household sizes that would be expected to demand such housing during the forecast period including the income levels and rent- to-income ratio(s) assumed in the study.
4. The study must reconcile the number of units in the proposed project with the demand estimate for the housing market area, taking into consideration current housing market conditions, available vacancy, and forecast additions to the supply (under construction and in the pipeline). This study should also include an estimate of the absorption period needed for the project to reach sustaining occupancy based on current market data and the *quantitative and qualitative demand* estimates.
5. The market study report must include an assessment of the impact the proposed project would have on existing rental developments. Specifically the study must address the impact on existing HUD insured properties and show that demand will come from new renter households, the shifting of households into the rental market, or the replacement of lost units. It must be demonstrated quantitatively that the

number of units under construction and the proposed supply, including the subject, will not create over-supplied or soft market conditions *overall*. Even if the subject does not directly compete with existing properties, FHA insured or otherwise, an oversupply of units could spill over into all segments of the market, with the exception of deep-subsidy projects such as project-based Section 8.

6. For Age Restricted Projects.

- a. The demand estimate should reflect "effective demand" and should be based on the numbers of elderly households meeting the relevant economic and demographic criteria (sufficient incomes, age, household size, and need for the type of shelter and care) that reasonably could be expected to demand such housing during the forecast period.
- b. The report must include a descriptive study of the demand estimate that addresses the primary determinants including:
 - (1) Current and forecast population and households of the target group(s) by age cohort and the proportion of the market each group comprises.
 - (2) Current income level/band of income of prospective households comprising demand, including cost/rent to income ratio(s) assumed in the study.
 - (3) Changes in the population (including migration patterns) of adult children of the potential elderly occupants. Discuss the impact of anticipated population changes on the demand for this facility. Indicate the proportion of demand expected to come from outside of the primary market area.

7. For Income Restricted Projects. Discuss demand and calculate the capture rate based on the eligible income band considering the proposed project's restricted unit mix and restricted rents. In calculating the capture rate it is important to confirm that the income qualified renter households in the HMA used in the determination have a similar eligible income band when compared to the subject. (See 7.5.D.6)

I. Additional Requirements for Age Restricted Projects - Basic Assumptions of the Study. The technical and analytical methods used by the market analyst and all subsequent findings and conclusions must be analytically and logically consistent with the following assumptions:

1. There is a direct relationship between the housing and needs or requirements of an elderly person and the limitations in activities of daily living imposed by the physiological, psychological, and social changes of the elderly. Therefore different age-cohorts of elderly have different propensities to consume (likelihood of need) a particular type of housing product.
2. The demand within each age-cohort for a particular type of product will depend on the housing and services offered and how well these meet the physical, mental and social conditions and service or care needs of persons within each age-cohort.

3. In addition to their normal source of income (pensions, social security, retirement funds) the elderly demanding shelter and care will use some portion of their assets (net worth) to defray the cost of shelter and care. Elderly homeowners will sell their homes and use part of the investment income from the net equity toward the monthly housing expenses.
4. The proportion of income an elderly household is willing to pay for a particular housing product (cost-to-income ratio) will depend on the type and extent of services included in the total monthly cost. The more extensive the level of shelter and services the higher the ratio. The cost to income ratio is defined as the sum of the shelter rent, utilities, and typical service charges, divided by the total monthly household income. Cost to income ratios are a function of the type of housing product and the level of services and amenities provided. The cost to income ratio used in the study should also reflect what is reasonable and customary for the particular type of housing in the subject market area, taking into consideration recent market experience of comparable and competitive product. A guideline for cost-to-income ratios for age-restricted rental apartments with no services would be 30 percent or less.
5. One-person households comprise the major segment of the demand for housing and supportive services for the elderly. Therefore any estimates of demand based on data for the total elderly population or for all elderly households, must be adjusted to be consistent with actual market experience and occupancy by household size in existing competitive product.
6. Household Sizes and Counts. MAP guidance does not preclude the use of data for all household sizes. However, any use of counts of all households must be adjusted to derive an accurate demand estimate, consistent with the characteristics of the target market. If an analyst makes an estimate of demand, using data for all households, without making an adjustment for household size, the subsequent estimate of potential demand will be overstated significantly.
7. Using counts for total households substantially overstates the number of income affordable households. Evidence from both the 1990 and 2000 Census indicate that incomes of two-person households are approximately twice that of respective one-person households. Consequently any distribution of elderly households will have a greater proportion of two-person households in the upper income ranges than one-person households. Analyses shows that at most every income level, two-person households typically out-number one-person households by a factor of two or three to one, depending on age (see Table 1. which follows).
8. Unless a factor is applied to the "all household" count to adjust for this bias the demand estimate is analytically incorrect. The method most analytically consistent with the observed facts of the target market for most seniors housing would be to measure the numbers of elderly one-person households, with incomes sufficient to afford the type of housing, and then adjust this count to take into account households of other sizes.

J. Additional Requirements/Guidance for Income Restricted Projects. According to USPAP Advisory Opinion 14:

“Subsidized housing may be defined as single- or multifamily residential real estate targeted for ownership or occupancy by low- or moderate-income households as a result of public programs and other financial tools that assist or subsidize the developer, purchaser, or tenant in exchange for restrictions on use and occupancy. While HUD provides the primary definition of income and asset eligibility standards for low- and moderate-income households, other federal, state, and local agencies define income eligibility standards for specific programs and developments under their jurisdictions.

Appraisers and analysts should be aware that the competency required to appraise or complete market studies on subsidized housing extends beyond typical multifamily residential experience. There needs to be an understanding of the various programs, definitions, and pertinent tax considerations involved in the particular assignment applicable to the location and development. Practitioners should be capable of analyzing the impact of the programs and definitions in the local subsidized housing submarket, as well as in the general market that is unaffected by subsidized housing programs. There also needs to be awareness of possible political changes that will affect the durability of the benefits and restrictions to subsidized housing projects and fully understand interpretation and enforcement of subsidy programs. A lack of knowledge and understanding of the impact of the various influences that affect subsidized housing projects could lead to misleading conclusions. Lenders should keep this in mind when seeking market studies and appraisal services on income restricted projects

K. Data, Estimates, and Forecast. The study should document the methods and techniques used to develop all estimates and forecasts; and provide adequate citations on the sources of all data, estimates and forecasts. The data and estimates provided should be relevant and current. Conclusions in the study must be consistent with the facts presented; findings and recommendations should be based on a reasonable forecast of market supply/demand conditions and sound assumptions regarding capture rates, absorption, achievable rents, income affordability and similar factors. To the extent possible the qualitative and quantitative estimates of demand for additional rental units should take into account the changes in renter households by household size, not just in total. MAP guidance does not preclude the use of data for all household sizes; however, study of the trend of change by household size may derive a more representative and accurate demand estimate consistent with the characteristics of the target market.

L. Useful Information. Distributions of renter households by size of household (1, 2, 3, 4, and 5 or more persons), in total and by age of householder (15 to 61, 62 to 74, or 75 and older) by income intervals as of the 1990 and 2000 Censuses are readily available free of charge from the Department of Housing and Urban Development's HUDUSER website, <http://www.huduser.org/datasets/spectabs.html>.

A. Each appraisal must meet the following requirements:

1. The appraisal must be procured and paid for by the Lender. The appraisal must identify the United States Department of Housing and Urban Development as an authorized user of the report.
2. Each appraisal work product shall be presented as a Self-Contained Report prepared in accordance with all applicable requirements contained in USPAP Standards Rule 2. The development of the appraisal must comply with USPAP Standards Rule 1, and the Scope of Work Rule and assignment conditions outlined throughout this guidebook. The report should contain all of the information necessary for loan underwriting and for HUD review appraisers to easily understand the reasoning employed by the appraiser.
3. **Complex or Unusual Appraisal Assignments.** Experience has shown that changes in the cost and manner of constructing and marketing commercial, industrial, and residential real estate as well as changes in the legal framework in which real property rights and interests are created, conveyed, and mortgaged have resulted in and will continue to result in corresponding changes in appraisal theory and practice. The appraisal profession is constantly reviewing and revising appraisal methodology to meet these changes. It is not possible for Department to issue guidance to address every scenario. When an appraisal assignment involves a subject with property rights issues or other unusual circumstances, third party appraisers must be sure to compliance with USPAP Standards Rule 1-1(a), “In developing a real property appraisal, an appraiser must be aware of, understand, and correctly employ those recognized methods and techniques that are necessary to produce a credible appraisal.”

NOTE: When an appraisal or consulting assignment involves complex or unusual valuation issues, the third party appraiser in conjunction with their client (the lender) should consult with the Processing Center or Headquarters, as appropriate, before beginning the assignment.

4. Form HUD-92264 and supporting forms, i.e., HUD-92264-A, HUD-92273, HUD-92274, and HUD 92264T (if applicable) must also be completed by the appraiser and included in the report. The self-contained report will be supportive of and consistent with the conclusions made on the forms.
5. The USPAP Jurisdictional Exception rule is not generally applicable in HUD appraisal assignments. Limitations on occupancy rates and commercial income/space, etc., imposed by the Department are considered to be conditions of the assignment.
6. **Definition of Value.** According to Chapter 7.1, value determinations for HUD’s multifamily programs generally involve either Market Value or a form of Investment Value. If the market conditions for the subject are consistent with the requirements off the particular Section of the Act (SOA) and other applicable requirements, then the definition of value will be that of Market Value. If the requirements for the assignment cause the appraiser to assume conditions that are atypical of market, then the definition of value will be that of Investment Value. In all cases, including the estimates of “as is” value in substantial rehabilitation cases, the appraiser is to assume the underwriting parameters (ie. occupancy percentage, commercial income limitations) required by the SOA under which the subject is to be insured, in the value estimate. A more detailed discussion of this topic is contained in Appendix 7A.

7. Occupancy Percentage. Underwritten physical occupancy shall not exceed the lesser of what is indicated by the market or:
 - a. 93% for market rate properties.
 - b. 95% if a property has at least 90% of units covered by a rental assistance contract, or affordable rent restrictions on 100% of units with all unit rents at least 20% below comparable market rents.
8. Sections 220, 221(d), and 231 (new construction only) are acceptable risk programs and do not call for an “as complete” value conclusion. The valuation work completed for these programs is considered an Appraisal Consulting Assignment subject to the development and reporting requirements outlined in Standards 4 and 5. However, the appraiser must ensure that any opinion of value used in the consulting assignment was developed in accordance with Standard 1.
 - a. These are replacement cost limited mortgages by mandate of the National Housing Act. Appraisals for these Sections of the Act require a site valuation, a debt service analysis and a cost approach to value. An estimate of the market value after completion is not a requirement. The appraiser must fully examine the proposed construction costs of the subject property. Plans, specifications and development costs must be presented, analyzed and supported by the cost approach using either a subscription cost service such as Marshall & Swift, the lender’s cost analyst or a direct comparative analysis of recently completed similar developments. Substantial Rehabilitation projects require an estimate of the “As Is” value of the property by use of the income and direct sales comparison approaches to value when possible. Shell structures may be appraised using the sales comparison approach only.
 - b. According to the USPAP, “Standard 5 does not dictate the form, format, or style of real property appraisal consulting reports. The form, format, and style of the report are functions of the needs of users and appraisers. The substantive content of a report determines its compliance.” Therefore, the appraiser and the MAP underwriter must assure that there is sufficient narration and exhibits to allow a reliable underwriting decision to be reached. This should include, but is not limited to, location maps, photographs of the subject, rent and expense comparable, site and floor plans, along with thorough explanations of all adjustments.
9. For Section 223(f) and Section 231 (Existing Projects), all three approaches to value must be utilized for subjects that have an actual age of less than ten years. When there are repairs or allowable improvements proposed, these appraisals are prepared hypothetically as if those repairs/improvements have been completed. Rents and expenses must reflect completion of the proposed repairs or improvements.
 - a. Cost/Summation Approach. The cost or summation approach must consider all applicable forms of depreciation, functional and external obsolescence. For this reason, the cost/summation approach shall not automatically set the upper limit of value for these programs. However, this policy is not intended to negate the necessity of the final reconciliation of the three approaches. These are value-based programs. It is rather, an acknowledgment of the basic principle of substitution in that no prudent purchaser would pay more for a property than the cost to acquire a similar site and construct improvements of equal desirability and utility. This approach may be eliminated at the discretion of the appraiser, for subjects that are ten or more years old.

- b. Sales Comparison Approach. In multifamily housing, the entire project does not offer a convenient basis for comparison with other entire projects since possible differences in size, composition, areas, units and rooms are almost unlimited. Acceptable units of comparison are price per living unit, price per room, price per square foot of gross building area (GBA) and gross rent multiplier (GRM).
 - c. Income Approach. The annual net operating income (NOI) remaining after the payment of expenses is considered to be the principle source of value to the property. The HUD/FHA preferred method of capitalizing the NOI into a value estimate is Direct Capitalization. There are several acceptable techniques for deriving capitalization rates such as Band of Investment, Ellwood, and Sinking Fund, etc. The Department does not authorize the use of Discounted Cash Flow Analysis for any MAP or TAP cases.
10. Remaining Economic Life (REL). REL is defined as the estimated period during which improvements will continue to contribute to property value; an estimate of the number of years remaining in the economic life of the structure or structural components as of the date of the appraisal.
- a. For new construction and substantial rehabilitation projects, HUD is required by regulation to set a maximum mortgage term at the lesser of 40 years, or 75% of the REL.
 - b. For existing properties, the maximum mortgage term is the lesser of 35 years, or 75% of the REL.
 - c. Estimation of the remaining economic life is first accomplished by determining the economic life of the improvements (as new) through market analysis and/or an appropriate reference source. The appraiser then reduces the economic life (as new) by the effective age to determine the estimated remaining economic life. I.e. Original economic life (55 years) reduced by the effective age (say 15 years) = 40 years estimated remaining economic life. The effective age is determined by the appraiser based on the actual condition of the subject considering all applicable forms of depreciation, and after assuming the required repairs to be made as specified in the PCNA as a condition of refinancing. The final remaining economic life is then multiplied by 75% to determine the maximum mortgage term as described above. In this example, the maximum allowable term for the mortgage would be 30 years (55 less 15 = 40 x .75 = 30). (The lesser of 35 years or 75% of remaining economic life (30). The methodology and reference/data sources used by the appraiser must be clearly set-forth in the self-contained report and must consider all of the following factors:
 - (1) The economic make-up of the community or region and the ongoing demand for accommodations of the type represented.
 - (2) The relationship between the property and the immediate environment. Older properties may possibly enjoy legally non-conforming use since they pre-dated any form of real property zoning for the neighborhood. Observations within the neighborhood in which the subject is situated might reveal a conflicting relationship. This should be fully explored to establish or debunk any potential existence of external obsolescence.

- (3) To the extent possible, the appraiser should analyze architectural design, style and utility from a functional point of view and the likelihood of obsolescence attributable to new inventions, new materials, changes in building codes, and changes in tastes. It is recognized that this sort of analysis requires speculation. The appraiser should indicate in the Scope of Work the steps taken to accomplish this requirement.
- (4) Trend and rate of change in the characteristics of the neighborhood that affect property values and their effect on those values.
- (5) Workmanship and durability of construction and the rapidity with which natural and man-made forces cause physical deterioration.
- (6) Physical condition and the practice of owners and occupants with respect to maintenance, the use or abuse to which the improvements are subjected, the physical deterioration and functional obsolescence within the subject property.

HUD considers the estimate of the Remaining Economic Life (REL) to be vital in determining the maximum insurable mortgage since it directly impacts the amortization period. An over-estimate of the REL can lead to an erroneous expansion of the dollar amount and term of the mortgage, thereby posing a greater and possibly unacceptable risk to the Department. An underestimate can unfairly penalize a project. HUD Review Appraisers should carefully scrutinize the methodology used in estimating the REL.

11. HUD expressly asserts its role as regulatory enforcement agency as outlined in the Confidentiality Rule of USPAP. Appraisers will be required to present their entire work file and fully disclose the identity and source of confidential information should the Department determine a review of the appraiser's work file is in order. (Note – that per USPAP, disclosure to enforcement agencies does not constitute a violation of the Confidentiality Rule). Any irregularities noted during the review process outlined herein may trigger a review of the appraiser's work file.
12. Effective Date. For pre-applications, all appraisals must have an effective date within 120 days before the date the pre-application package is delivered by the Lender to HUD. For Firm Commitments, all appraisals must have an effective date within 180 days prior to the issuance, re-issuance or amendment of the Firm Commitment. HUD defines the effective date as the most current date that the appraiser inspected the subject, comparables and made estimates of rents and expenses. Updated appraisals can be submitted with the appraiser re-inspecting the subject property, re-surveying the rental comparables, and reviewing the market for any additional sales comparables. Follow USPAP Advisory Opinion 3 for guidance on completing and reporting appraisal updates.
13. The appraisal must be prepared with the list of information supplied by the MAP Lender contained in Appendix 4.
14. Include an appraiser's certification. See certification format in Chapter 11 of MAP Guide.
15. Inspection of the Subject and Comparables. Requirements. The primary appraiser designated by the Lender and accepted by HUD must physically inspect the subject (both exterior and interior) and all of the comparables used as part of the analysis. The primary appraiser must also sign the Certification within the appraisal report and the supporting HUD forms.

- a. The primary appraiser must inspect at least one of each bedroom/unit type. The total number of units inspected must equal or exceed 5% of the total number of units for projects of up to 200-units, or 4% of the total number of units/beds for projects greater than 200-units. If the characteristics and/or condition of the subject indicate that a higher level of inspection is necessary, it is the appraiser's responsibility to expand the scope of the work as is necessitated by the observations made by the primary appraiser during the inspection of the subject. This is especially important where the improvements are high-rise structures whereby individual units within demonstrate varying degrees of light and view qualities. If there are hazardous conditions or other factors that preclude a thorough inspection of the interior, the appraiser must clearly indicate these circumstances in the appraisal report.
 - b. For large projects exceeding 500 units, the appraiser must consult with the processing office to agree on a reasonable number of units to be inspected. In addition, the appraiser may employ assistants to inspect individual units. The purpose of allowing assistants is to encourage a thorough inspection. The names and qualifications of these assistants must be disclosed in the appraisal report. The assistants are not required to sign the report.
 - c. The primary appraiser must inspect all of the comparables used in deriving and estimate of value. This includes land comparables (if applicable), improved comparables sales, expense comparables and rental comparables. The appraiser must verify the condition of the comparables at the time of transfer/rental with management or other personnel familiar with the property. Contact information must be documented in the appraisal report.
16. Required Appraisal Report Exhibits. Photographs (subject, and all comparables including rentals), Regional Map, Location Map, Satellite Scans (if available - Google, Bing, etc.), Flood Hazard Map, Survey (if available), Floor Plans (for each type of unit being offered - if available), Site Plan (if available), Zoning Map (if available), Tax Map (if available) Land Sales Comparable Map, Rental Comparable Map, Improved Sales Comparable Map are required with all submissions.
17. Market Analysis Requirements for Multifamily Appraisals. The appraisal report must also contain, depending on the complexity of the project and prevailing market conditions, a Level B or C Market Analysis of the local market with an emphasis on multifamily housings. The purpose of the analysis is to determine the ability of an existing property to continue usage as a Multifamily Housing project. In the case of proposed construction or substantial rehabilitation, the purpose would be to determine overall feasibility and demand for new housing units. In these cases the appraiser should also review the market study obtained by the lender. Information from the market study may be used in the market analysis provided the appraiser has performed adequate due diligence. The analysis should assume that management has budgeting and operations under control. A brief outline of a Level C analysis is as follows:
- a. Location. This includes a general description, specific analyses of site linkages and urban growth determinants and detailed competitive location rating.
 - b. Demand Analysis. There must be a discussion of general evidence of sales/leasing activity, general city/area growth trends, market absorption, demand and need forecast

based on population, employment and income and a demand forecast of the subject market segment.

- c. Competitive Supply Analysis. This must include vacancy rates for comparables and from market surveys (secondary data), field research on all competitive and proposed properties, building permit analysis, identification of proposed sites, and a detailed competitive amenities rating.

The detailed requirements for performing a Level B or C analysis can be found in “Market Analysis for Real Estate”, published by the Appraisal Institute. In general, a stable market evidenced by a recent sales, and balanced supply and demand is an indication that a lower level “B” analysis would be sufficient. If there is uncertainty in determining the level of analysis, the lender and appraiser should jointly consult with the processing office.

- B. As the basis of determining value, the appraiser may not consider, analyze, or report any information that makes reference to race, color, sex, handicap, familial status, religion, or national origin of the geographic area, neighborhood, occupants, owners or prospective owners. HUD will reject any Firm Commitment application for mortgage insurance that considers any of these issues in the preparation of an appraisal. The certification required by USPAP must include a statement that the racial/ethnic composition of the neighborhood surrounding the property in no way affected the appraisal determination.

- A. Rental estimates. First the annual gross income of the subject project is estimated. The processing will include estimates of income from market comparables, rental concessions, and an assessment of the general health of the rental market. The gross income estimate assumes a 100 percent occupancy level and reflects rent levels current as of the appraisal date or date of the market study. Also, the effect that any proposed repairs to the project will have on rents, expenses, and net income must be considered. (Not all repairs increase rents, occupancy, net income, and/or decrease expenses.
- B. Rent comparables. Market Rent by Comparison shall be estimated by the Lender's appraiser by completing HUD-92273. Note that use of Form HUD-92273-S8 is not authorized for FHA mortgage application processing.
1. One HUD-92273 form is to be prepared for each type and size (if significantly different) of rental unit in the subject property.
 2. The rent comparables and units selected for comparison shall be as similar as possible to the subject property and units as they relate to location, structural type, number of bedrooms, and average unit size. Appraisers should refrain from using rent comparables located outside of the subject's market area to insure that they are truly comparable and competitive with the subject property.
 3. Market rate units from partially assisted projects can be used as rental comparables in the absence of better rental data.
 4. Consistent adjustments for significant differences between the comparables and the subject units shall be derived from the market and applied to the subject rent estimate. Rental adjustments are always made to the comparables for differences from the subject project.
 5. The Lender's appraiser should select the final rent estimate based on accepted correlation procedures:
 - a. Generally, the indicated rent estimate will be from the central 60 percent of the rental range of the indicated rents after proper adjustment. In situations, where the appraiser gives the greatest weight to the highest or lowest comparables, the appraiser must explain and substantiate with market data why the chosen comparables are the most reliable. Often, the best comparables are those that require the least amount of adjustment.
 - b. Just as the most appropriate rent comparable must receive more weight, the general health of the rental market must be recognized before relying upon one or two optimistic indicators.
- C. On tax credit and/or bond financed applications the appraiser must also complete the HUD-92264T in determining the appropriate processing rents.
- D. Rents as of the appraisal date or market study date. Rather than being trended to some future date, rental estimates shall be made as of the appraisal or market study date. Since rent estimates are made based upon street rents currently being obtained by the comparables, no time adjustment is needed for an estimate as of the appraisal or market study date.
- E. Equipment and services included in the subject rent must be identified—such as ranges, refrigerators, microwave ovens, air conditioning equipment and laundry facilities. Services frequently included are heat, air conditioning, water, trash removal services, etc. Comparable project equipment and services must correspond to the same items of equipment and services

provided by the owner for the subject proposal. The adjustment process must reconcile differences between comparable equipment and services and those of the subject proposal. Note: The above also applies to the expense analysis.

F. Vacancy and collection losses.

1. The Lender's appraiser must establish a factor for vacancy and collection loss when determining the effective gross annual income for the residential units. The factor must consider both historical and current data (applicable for existing properties) of the subject property, the rental comparables, and any anticipated changes in the market. The factor selected must reflect long-term occupancy rates that are expected to continue.
2. The vacancy and collection loss rate used by the Lender's appraiser may not be less than 7 percent. This requirement applies to all programs under MAP and TAP.

G. Where commercial facilities are included in a project, a separate analysis must be made of the effect that the commercial operation will have on the project. The appraiser must calculate income, vacancy and collection loss, operating expenses, and replacement reserves attributable to commercial space separately from the residential. Tenant improvements should be accounted for as a leasing expense, and if applicable a separate commercial-space operating deficit should be calculated in addition to the required residential operating deficit. An individual analysis must be performed for each type space using the HUD Form 92273 or a similar format to summarize appropriate adjustments to comparable data. These studies can be incorporated as a separate section in the overall residential market study submitted at the pre-application or firm stages, depending on the program requirements. In addition to the following requirements, the study must also comply with Appendix 7A. Care must be taken in reviewing the allowable square footage and income percentage attributable to the commercial/office space. These requirements vary by program. See Chapter 3 for a more complete synopsis of space and income limitations.

1. The Lender's appraiser must: Conduct a complete analysis of at least three commercial income and expense comparables. Provide for each comparable; a photograph, the tenant's name, type and address of business, square feet, rent, vacancy, any concessions and major lease terms. Provide data to support the subject's commercial vacancy rate in relation to the market commercial vacancy rate and review the rollover risk and cost of tenant improvements to re-lease space. Use a vacancy factor of not less than 10 percent for Section 223(f) and 20 percent for Section 221d, and Section 220 new construction/substantial rehabilitation to obtain effective gross commercial income for underwriting purposes. Provide for each lease, the term, commencement date, expiration date, and name of the tenant, square footage, and calculation of gross rents, expenses, reimbursement of expenses, cancellation clauses, and renewal clauses.
2. Limitations on the amount of commercial space and income vary by program. (See Chapter 3)
3. The project expense estimate must include all commercial expenses payable by the project owner. The analysis of all commercial income and expenses must be reflected on Form HUD-92264 with all the supporting data attached to the form.

H. Project rent concessions. Rent concessions in a comparable must be included in the analysis and an appropriate adjustment made to the rent from that comparable unit. In all cases, adjustments must reflect the actual impact on gross annual income resulting from the comparable rental concession.

I. Occupancy. When the occupancy rate in a comparable project is significantly less than the long-term occupancy rate estimated for the subject, a downward adjustment should be made to the comparable's rent. NOTE: If other factors such as condition have had an effect on occupancy, care should be taken to avoid excessive adjustments for interdependent factors.

J. Utilities/Services. All of the items for consideration under this heading refer to the cost of the services of water, sewer, gas and electricity included in the rent. In some cases, even though both the subject and the comparable units have the same service included in the rent, an adjustment may still be warranted to bring the comparable in line with the subject, due to size, equipment, utility rate, type of utility, etc. If included in the comparable rent, but not in the subject, enter a minus adjustment reflecting the portion of the comparable's rent attributable to the inclusion of the service. If excluded from the comparable rent, but included in the subject rent, enter a plus adjustment reflecting the estimated increase in rental value attributable to including the service in the subject's rent.

K. Project location. Consider the subject location relative to distance from shopping, recreational, social, and medical and employment centers, neighborhood desirability, transportation, special hazards and nuisances.

L. Project amenities.

1. Among those "other" items that may be considered, but are not limited to, are the following:
 - a. Livability—reflect good or poor room sizes, layout adequacy of closets, lighting, elevators and laundry facilities, etc.
 - b. Condition of improvements—reflect lack of maintenance, soundproofing, etc.
 - c. Parking—reflect parking rates, adequacy of parking for visitors, proximity of parking to the units, inclusion/exclusion of parking space with unit rental, etc.
 - d. Project density—consider open space or crowding of units, if the degree of either is such that it would affect the level of attainable rental.
 - e. Unit location—reflect here features of location of unit within the project, such as view, proximity to swimming pool, tennis or other recreational facility, and/or other factors of this nature.
2. Elevator rents. Only high-rise elevator comparables are to be compared with the subject elevator high-rise proposal. Mid-floor level rents of the comparables are compared with the mid-floor level of the subject project. Adjustments for heights of the comparables above and below the mid-floor level of the subject also must be made, as indicated by the market.

M. Other Income

1. Ancillary Income. The Lender may consider income from tenant related sources including, but not limited to, laundry facilities, parking, and other recurring and reliable sources such as equipment rental, vending machines, and cable fees in the calculation of income based on the operating history of the project, if applicable, and whether income from these sources are common in the market. The Lender can consider the net amount of this income based on the actual or projected (as appropriate) amount received, adjusted for vacancy and income loss. The analysis must be discussed in the Remarks Section of Form HUD-92264.
2. Commercial Income. The term "Commercial" is applied to any space or facility permitted and acceptable for "Nonresidential Use" from which income is derived or anticipated. Income from tenants for the use of facilities such as community rooms and garages are not considered commercial even though fees may be collected. This income is considered as ancillary income and is treated separately (as noted above) from commercial income. However, income related to parking, swim club or other community facilities from non-tenants must be treated as commercial income and subject to the restrictions on the underwritten occupancy rate as noted in Chapter 3. The space occupied by parking, swim clubs and community facilities is not included in the calculation for allowable commercial space.

3. Day Care Facilities. Space for day care facilities must be adequate, appropriate to the market need, and conform to local and State requirements. In processing, it is considered as "Commercial" space/income except that the area of space for day care facilities may be provided over and above the maximum area allowed for commercial uses as stated in Chapter 3. Income parameters remain unchanged.
4. Short-Term Lease Premiums. Projects that provide leases with terms that are less than 30 days are not eligible for HUD-insured financing under any circumstances. Income from other short-term leases may be considered to the extent that it is present in the local market. There must be a thorough discussion of the prevalence of short-term leases in both the appraisal and underwriting summary.
5. Corporate Leases. Corporations and Businesses are eligible residential tenants in HUD-insured projects, so long as the lease term exceeds 30 or more days. Compliance is required with the policy on Short-Term Lease Premiums (above). For underwriting and valuation purposes the percentage of total gross income obtained from corporate leases shall not exceed 10%.
6. Ineligible Income. Ineligible income should be noted and discussed in both the self-contained appraisal report and the Remarks section of the form HUD 92264. There is no prohibition on this category of income. It simply cannot be included in the income calculation for the purposes of determining value or the maximum insurable mortgage. Ineligible income includes the following items:
 - a. Interest Income. The lender must not include in the calculation of income any interest income, including interest on reserves.
 - b. Ineligible Fee Income. Non-recurring and non-regular income that is not reliable may not be included in the calculation of income. Examples include, but are not limited to pet fees, pool fees and forfeited security deposits.
 - c. Furnished Units. Furnished units must be underwritten at the same amount as for unfurnished units. This also applies to all units including corporate and short-term leases.
7. Non-Shelter Services. Non-shelter services shall not be made a mandatory condition of occupancy, or offered as an optional service. This includes, but is not limited to maid service, transportation service, infirmaries or clinics. These services shall not be included in the proposal or offered through or associated with the project.

NOTE: The total amount of other income as a percentage of total gross income should not exceed what is prevalent in the subject's market area. This should be addressed in the appraisal and underwriting summary.

- N. Elderly Developments. Refer to the requirements contained in 3.5.C.

7.8

Operating Expense Estimates

- A. Purpose. A determination is made of the portion of gross income, which must be used to maintain, operate, and repair the property and to defray the costs of ownership arising from it. An accurate analysis of operating expenses is essential in determining a realistic net income estimate for the project.

Form HUD-92274, Operating Expense Analysis Worksheet, is used for the development of project expense estimates for Section E of Form HUD-92264, Project Income Analysis and Appraisal.

Form HUD-92274 will be prepared for all cases processed. It is included in the processing file as supporting documentation for Form HUD-92264.

B. Sources of expense data.

1. For new construction projects, operating expenses must be estimated on the basis of comparable projects.
2. For existing projects, operating expenses must be estimated on the basis of comparable projects, as well as tested against the past 3 years of operating experience for the subject project. In addition, the lenders should provide trailing 12 months of income and expenses for the appraiser to compare to the historical statements.

- a. The most current year financial statements must have a third party CPA review. Owner certified financial statements may be submitted for the remaining years.. Any owner-certified financial statement or owner-certified balance sheet and operating statement must include the following acknowledgment:

“WARNING: 18 U.S.C. 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document or writing containing any false, fictitious, or fraudulent statement or entry, in any matter within jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than five years, or both.”

- b. Exceptions. For refinance transactions where the project may not have been under the current ownership for the 3-year period financial statements for the entire 3 years may not be available. This is particularly true for bankruptcies or the acquisition of defaulted properties. Also, in purchase transactions, such as acquisition through adversarial action, not all the required information may be available for reasons beyond the purchaser’s control. In these situations, the mortgagor must submit a statement through the lender that explains why all the required records are not obtainable and the lender must certify to the Department, stating that he has evaluated the mortgagor’s statement and agrees that the information is not available. Upon which the Hub Director may at their discretion waive the requirement for past 3-year period financial statements. However, the mortgagor must submit the project financial statements that are available including an owner-certified year-to-date balance sheet and operating statement.

3. It must be remembered that all projects must be analyzed as an independent operation and must not reflect shared expenses from nearby projects under the same management. If the nearby project should be subjected to foreclosure, the subject project would be adversely affected, thereby constituting an unacceptable underwriting risk. Furthermore, for the same reason, estimated expenses must reflect typical long-term operation and must not reflect a specific sponsor or management entity whose operation would not be typical.

- C. General: Operating expenses are periodic expenses needed to maintain real property and to continue the production of its effective gross income. For appraisal purposes, an operating statement that conforms to the above definition of operating expenses may differ from statements prepared for accounting purposes. Current or historic statements prepared for a property being appraised are either on a cash or accrual basis. It is important to know the accounting basis for the operating statement, since project operating expenses for appraisal purposes must be reported on a cash basis. Typical categories of expenses are as follows:

1. Fixed expenses. Fixed expenses are those that generally do not vary with occupancy and that has to be paid regardless of whether the property is occupied or vacant. Real estate taxes and insurance costs are typically included as fixed expenses. These expenses generally do not fluctuate greatly from year to year.
2. Variable expenses. Variable expenses comprise operating expenses that generally vary with the level of occupancy or the intensity of property operation. Operating expenses for large properties frequently list many types of expense variables, but typical broad categories include the following:
 - a. Management charges.
 - b. Utilities – electricity, gas, water, sewer charges.
 - c. Heating and air conditioning (HVAC)
 - d. General payroll and security
 - e. Cleaning expenses.
 - f. Maintenance and repairs
 - g. Decorating
 - h. Grounds maintenance
 - i. Exterminating
 - j. Trash removal
 - k. Miscellaneous (supplies, etc.).
3. Reserve for replacements. This reserve category provides for the periodic replacement of the building components that wear out more rapidly than the building shell itself and must be replaced periodically during the building's economic life. These components may include but are not limited to roof covering, carpeting, plumbing fixtures, appliances and HVAC.

Annual deposits to replacement reserves are calculated as follows:

Sections 220, 221, and 231(new construction only):

- New construction: The greater of \$250 per unit or 0.006 multiplied by Total Structure Cost.
- Substantial rehabilitation: The greater of \$250 per unit or 0.004 multiplied by the Mortgage Amount.

Section 223(f) and Section 231 (existing). The minimum reserve for replacement deposit is \$250 per unit per year or such higher amount as is indicated by the PCNA, even with an initial deposit to the reserve for replacement escrow.

4. Total operating expenses. Total operating expenses for residential properties are the sum of the fixed expenses and variable expenses updated to the appraisal date, plus the reserve for replacements.
5. Commercial facilities. Where commercial facilities are included in the subject project, a separate analysis must be made of the effect that the commercial operation will have on the project expense estimate.

- B. Estimate of operating expenses by units of comparison. Items of expense shown under each comparable and the expense items applicable to the subject proposal reflected in a suitable unit of comparison—such as expense per unit per annum (PUPA), expense per room per annum (PRPA), and expense per square foot of net rentable area per annum (PSFPA), or percent of effective gross income. The expense comparables and units selected must be as similar as possible to the subject project and units as they relate to the subject location, structural type, number of bedrooms, and average unit size.

For consistency purposes, expense components must be expressed in the same units of comparison so that the expenses for the subject proposal can be totaled. However, if the unit of comparison for a specific component is different from the basic unit of comparison for the other expense items, this different unit of comparison must be explained in the expense narrative. The dollar amount of the expense item can afterwards be converted to the same unit of comparison selected for the other expense components. Additional documentation must be submitted, as needed, for all component estimates that are not self-explanatory.

- E. Expense Comparables. All FHA insured properties used as expense comparables must be fully identified and disclosed in the appraiser's form HUD 92274, expense analysis and in the appraisal report, except as noted below.

1. General Requirements. The appraiser may include confidential expense comparables in the expense analysis, however, the analysis must include at least one fully identified and disclosed expense comparable to serve as a benchmark. Appraisers may only use confidential expense comparables that are supportive and consistent with the fully disclosed comparable(s) used in the analysis. All comparables (confidential and disclosed) must be representative of the physical and location-specific characteristics of the subject property. It is unacceptable for the appraiser to base the conclusions of the analysis on confidential expense comparables that are not supported by the fully disclosed comparable(s) used in the analysis.
2. Confidential Expense Data. When submitting confidential expense comparables, the appraiser must redact only the minimum amount of information necessary to protect the confidentiality of their client. The city, state, and general market area within the city must be disclosed unless this information would clearly identify the comparable and thus breach the appraiser's confidentiality requirement. Otherwise, this information must be presented. The property description, unit mix, and the physical characteristics of the comparable's units must be disclosed.
3. Quality of Comparables. Appraisers must always present the best comparables available for their analysis and must refrain from repeatedly using the same disclosed comparable merely to meet the disclosure requirement.
4. HUD Review of Expense Comparables. The HUD Review Appraiser will compare the FASS System file for the HUD insured expense comparable used by the MAP Lender's appraiser to confirm the data. In order to accomplish this, the HUD review appraiser will combine the following accounts; Acct. No. 6263T, Administrative Expenses (subtract Acct. No. 6203, Conventions and Meetings, and 6370, Bad Debts), Acct. No. 6400T, Utility Expenses, Acct. No. 6500T, Operating and Maintenance Expenses, and Acct. No. 6700T, Taxes and Insurance. When reviewing a Nursing Home, ALF, or Board and Care, the review appraiser must also use Acct. No. 6900T in addition to the previous four accounts.

- F. Expense adjustments. Project expenses must be expressed in the same units of comparison in order to ensure accurate adjustments and correct reporting of expense estimates. Consistent

adjustments for significant differences between the comparables and the subject units shall be derived from the market and applied to the indicated subject expense estimate.

The appraiser must enter the dollar amounts attributable to significant differences between the subject proposal and each of the expense comparables—such as for physical characteristics, equipment, services provided, the level of management furnished to tenants and any differences in rates between tax and utility jurisdictions. Next, the process of correlation must be used to correlate the comparable expense for each component which is applicable to the subject project.

- G. Updating procedures. It should be stressed that HUD no longer uses a “trended to” procedure to reflect a time adjustment from the effective date of the most recent expense comparable to the anticipated date of project occupancy following construction and initial endorsement. Expenses estimates must be effective as of the date of the appraisal. Income and expense estimates must reflect the same year of operation.

HUD does allow the appraiser to use an updating percentage to bring expense comparables up to the same date as the most current expense comparable in order to make a more creditable comparison. However, if all of the expense comparables have data from the same operating year, no updating percentage is necessary.

Updating Expense Data is a Two Stage Process.

First, the oldest comparables are updated to the date of the most recent comparable, so that all comparable data is representative of the same effective time period. Then, after updating the comparables to the same effective time period, the line items are correlated, and the subject's expenses estimate is then updated to the date of the appraisal.

1. The most current comparable is entered in the first column on the HUD 92274
2. This comparable serves as the benchmark for updating the remaining comparables.
3. Remember that the effective date of the operating expense data is always the BEGINNING date of the operating year, i.e. the beginning date of a financial statement dated January 1st to December 31st is January 1st of that year. If the financial statement fiscal year ends June 30, 2000, the beginning date is July 1, 1999.
4. Other than the first comparable being the most recent, the remaining comparables do not necessarily need to be in chronological order.
5. The appraiser enters the comparables' itemized expenses as reported on audited or certified financial statements. **Per Unit Expenses or Per Square Foot Expenses are Treated Similarly:**
 - a. The actual expense amount is entered in the first column, without any adjustments.
 - b. Once the adjusted per unit expenses are determined for each comparable, the subject property's expenses are then correlated from the array.
 - c. Once the correlated line item expenses for the subject property are determined, they are added AND THEN updated to the date of the appraisal.
 - d. The correlated subject expenses are updated based upon the BEGINNING date of the expense period of the most recent (the benchmark) comparable. HUD has the right to request from the Lender's appraiser the names and addresses of any confidential expense comparables used in the expense analysis. The Confidentiality sub-section of the Ethics Rule, along with Standards 3.1.e and 3.2.f of the Uniform Standards of Professional Practice (USPAP) support this position. If the appraiser still refuses to provide this information, the HUD appraiser has the right to request from the contract appraiser additional non-confidential comparables.

7.9

Site Analysis

Key analyses for consideration of site acceptability for a proposed project are as follows:

- A. Analysis of location. The analysis of location involves a determination of the desirability and utility of the site by reason of its location. The analysis of location requires a forecast of the changes likely to be experienced at the site due to probable future neighborhood trends in addition to an appraisal of the present situation. The pattern of appropriate improvements, the level of available rents, the level of warranted costs of construction, and the probable economic life of the structures are to a high degree determined by location factors.

- B. Specific location. The specific site is considered in relation to neighborhood and city-wide physical, social, and economic influences. Limitations of use imposed by zoning or deed restrictions are discovered. Trends of development, stability, decay, and rehabilitation are discovered. Availability of utilities, services, and centers appropriate for the intended use are identified. The many and varied influences operating on the site which affects its market and income potential, when improved, is analyzed. This includes a review of the crime rate in the area, its impact on the proposal and how the impact, if any, can be addressed through design or staffing. It should be noted that any conclusions made regarding the impact of the crime rate must be correlated to the actions of the market. (For further guidance; consult USPAP Advisory Opinion 16, "Fair Housing Laws and Appraisal Report Content").
- C. Civic, social and commercial centers. When judging the desirability of a location, full consideration must be given to the sufficiency of community facilities as they relate to the needs of tenants of the proposed project. A location for a multifamily project must be adequately served by grade and high schools, neighborhood shopping centers, churches, playgrounds, parks, libraries, hospitals, and theaters and other appropriate linkages.
1. Schools. Accessibility to schools will be judged by the time involved, utilizing the means provided, or available, rather than walking distance alone. Thus, if school bus service will be provided and the time involved is reasonable, the location is acceptable. Overcrowded schools are the responsibility of the community in the granting of permitting zoning and the issuance of building permits. A project that is otherwise feasible will not be rejected because the local schools are considered overcrowded, unless it can be proven that marketability has been adversely affected. School accessibility will not be a factor in projects designed for the elderly.
 2. Neighborhood shopping centers. The convenience of a shopping facility must be judged on the basis of time rather than distance. The importance of grocery, drug, and other neighborhood shopping facilities within a reasonable walking distance will generally increase with the number of tenants who do not have private transportation.
 3. Religious and recreation centers. Ready access to religious and recreation centers is desirable. Projects designed for large families (predominantly three- and four-bedroom units) have a greater need for playgrounds and active recreation areas. Adequate on-site provisions for playgrounds and other recreation areas must be incorporated into the proposal where adequate facilities are not in close proximity to the project site and available to the occupants.
- D. Transportation. Convenient transportation to places of employment, major shopping districts, civic and social centers is a prerequisite to project location acceptability. In those communities where local public transportation is the principal means of commuting by the prospective tenants, the location of a project designed for such occupancy shall be within a reasonable walking distance to mass transit.
- E. Special hazards and nuisances. Such conditions include unusual topography, subsidence, flooding, unstable soils, unusual traffic hazards and noise, danger from fire and explosion, exposure to airport noise and low-flying airplanes, smoke, chemical fumes, noxious odors, stagnant ponds or marshes, and sewage disposal failure. Any of these, or similar conditions, if serious and infeasible to overcome, will render a specific location ineligible for mortgage insurance.
- F. Parking facilities. Consideration must be given to the effect on parking facilities in the neighborhood and on all-night parking, in particular, which would be caused by the additional number of cars of the tenants who would live in the proposed project. If the project site lacks

adequate space for parking tenants' cars, the availability of other off-street parking space must be considered. An estimate shall be made of the number of parking spaces which would be required by the tenants of the proposed project and their guests and a recommendation shall be given as to the adequacy of the parking facilities to meet the estimated need.

G. Site suitability. The site must be adequate in size, shape, exposure, and contour for the proposed project. Building height limitation, project unit size and numbers, necessary on-site parking and play areas must be considered.

H. Sites/Projects Sold by a Public Body.

1. The Market Value of Land Fully Improved or the "As Is" Value of a Proposed Substantial Rehabilitation Project. For underwriting purposes, where sites/projects are sold by a public body to the developer for a specific re-use purpose, the Value of Land Fully Improved is the lesser of:

a. The amount found by comparison with other sites having the improvements and amenities that the subject site will have upon completion.

b. The dollar amount paid by the purchaser as set forth under terms of the purchase contract with the public body, plus an estimate of those costs, if any, additionally imposed under its terms or by HUD-FHA. Costs referenced above are those to be borne by the purchaser because of terms of the purchase contract, e.g., real estate taxes and special assessments accruing from date of purchase to date of commitment, legal fees incident to the land/project purchase, re-zoning costs, installation of certain designated off-site improvements, interest on investment in site from date of purchase to date of appraisal, razing structures and clearance of the site (after allowance for any income to the purchaser). This is not a complete list of items covered but these will serve as a guide to such costs required by the purchase contract.

NOTE: When subject is a site or project sold by a public body, the appraiser must still provide an estimate of market value of land or the "as is" market value of an existing project. This should be noted in the remarks section of the form HUD 92264.

2. "As-Is" Value of Land. The Assistant Secretary-FHA Commissioner's Estimated Value of Land or Project "As is" for Cost Certification may include all of the items in paragraph 1.b above with the following exceptions: Installation of off-site improvements and cost of razing structures and clearing the site (less income received). This is intended to avoid duplication of costs that might be reflected in the Estimated Value of Land "As Is" and also allows for the sponsor to include them as separate items in Cost Certification which includes both off-site costs and demolition. The dollar amount of the land purchase contract plus a breakdown of the estimate of additional costs must be fully itemized and documented.

I. Site Value for Subsidized and/or Low Income Housing Tax Credit Applications: The site value is estimated without considering subsidies to be made available to the project, or any LIHTCs or other tax benefits the property will receive. Nor should the value estimate be negatively affected by any perceived value limitations due to regulatory agreements or restrictions opposed by any subsidy program or tax regulation. This permits Sponsors to acquire property for new construction or rehabilitation at its market value. The value attributable to the presence of LIHTC's diminishes over time and is not always freely transferable.

- J. Warehousing of “excess” land area is not encouraged but where un-avoidable, it may be permitted without the advance of insured funds. Refer to Chapter 8 for the cost calculation.

7.10

Pre-Application Stage for Sections 220, 221(d) and 231 (New Construction)

A. Exhibits:

1. Application for Multifamily Housing Project, Form HUD-92013
2. Location map
3. Phase I Environmental Site Assessment (ESA) with a narrative environmental report. If the Phase I Assessment indicates a need for further study, a Phase II Assessment should also be submitted at this time. All environmental assessments should identify the United States Department of Housing and Urban Development as an authorized user of the report(s).
4. Evidence of site control (deed, purchase agreement, or option)
5. Market study with comparables
6. Estimate of Market Rent by Comparison, HUD-92273
7. Photographs and location map of rental comparables used in the HUD-92273 analysis.
8. Operating Expense Analysis Worksheet, HUD-92274

B. Lender’s responsibilities:

1. Based upon the market study prepared by the Lender’s market analyst and the rental income and expense estimates prepared by the Lender’s appraiser, the Lender is responsible for making the following determinations before recommending the proposed project to HUD:
 - a. Determine the current occupancy levels, market absorption rates, and market demand for the number and type of units proposed.
 - b. Analyze site for acceptability in accordance with Section 7.9.
 - c. Determine market rents reflecting amenities, services, equipment offered and estimate project income utilizing the methodology in Section 7.7.
 - e. Estimate total operating expenses in accordance with Section 7.8.
 - f. Estimate mortgage amount based on HUD 92264-A, Criteria 5, Debt Service Ratio.
 - g. Make a determination of feasibility or non-feasibility of the sponsor’s proposal.
2. The MAP Lender will have the Phase I ESA self-contained report prepared in accordance with Chapter 9. All environmental assessments should identify the United States Department of Housing and Urban Development as an authorized user of the report(s).
3. The Lender’s appraiser or market analyst will prepare the market study and project comparables in accordance with the requirements of Sections 7.5, 7.6, and 7.7.
4. The Lender’s appraiser will determine project rents, estimated rental income, and operating expenses by completing forms HUD-92273, Estimate of Market Rent by Comparison, and HUD-92274, Operating Expense Analysis Worksheet, in accordance with Section 7.7 and 7.8 of this chapter. The forms and specific instructions to complete the forms can be found in the MAP Forms Book. For projects receiving Substantial Rehabilitation the Lender’s appraiser

will complete the HUD-92273 and HUD-92274 forms based on the assumption that all proposed substantial rehabilitation to the project has been completed.

5. The MAP Lender will utilize information and soft-cost and land cost information provided by the sponsor to calculate the total replacement cost. The Lender will compare its estimate of the total replacement cost with the mortgagor's amount.
6. The MAP Lender will also complete income, expenses, and total settlement portions of the HUD-92013 utilizing information from the comparables.
7. The Lender will compare the calculations on the HUD-92013 with those proposed by the mortgagor and either accepts the mortgagor's proposal, recommend its modification, or reject it and advise the mortgagor that the project is infeasible.

C. HUD Review:

1. The Lender will submit the exhibits listed in Section 7.9.A to HUD.
2. The HUD appraiser and the EMAS economist will each provide a desk review of the market study submitted by the Lender. EMAS will not perform its own market analysis of a particular project. The EMAS advisor review would be provided to the team leader who would in turn provide it to the HUD appraiser. The HUD appraiser makes final recommendations to the team leader regarding market demand for the project.
3. The HUD appraiser will inspect the subject site and all of the comparables used in the Lender's appraiser's HUD-92273 and HUD-92274 analyses.
4. In accordance with Chapter 9, the HUD appraiser will review the Lender-submitted Phase I ESA, prepare as much as possible HUD-4128, "Environmental Assessment and Compliance Findings for Related Laws" and the sample field notes checklist available on HUD Clips.
5. The HUD appraiser will review site characteristics for compliance to requirements found in Section 7.9. Based on the environmental analyses, and the site visits, the HUD appraiser will make a recommendation regarding site acceptability to the Team Leader.
6. The HUD appraiser will determine that the projects submitted as comparables to the subject property are acceptable comparables.
7. From a review of Forms HUD-92013, HUD-92273 and HUD-92274, and supporting information, the HUD appraiser will make a recommendation (Format in Appendix 7C) to the Team Leader regarding:
 - a. The acceptability/unacceptability of proposed rents and estimated rental income and their compliance to requirements found in Section 7.7.
 - b. The acceptability/unacceptability of total operating expenses and compliance to requirements found in Section 7.8.
 - c. Any required modifications necessary to approve the project's application instead of a categorical rejection. NOTE: Any value conclusions made by the HUD Review Appraiser that differ from the work under review; require the development of a work file in accordance with Standards 1 and 2 of USPAP.

A. Exhibits:

1. Application for Multifamily Housing Project, Form HUD-92013
2. Evidence of permissive zoning
3. Evidence of last arms-length transaction and price
4. Appraisal as described in Section 7.4
5. Rental Housing Project Income Analysis and Appraisal Form, HUD-92264
6. Appraiser's trial, Supplement to Project Analysis, HUD-92264-A
7. Updated estimates of Market Rent by Comparison, HUD-92273
8. Updated operating Expense Analysis Worksheet, HUD-92274
9. All exhibits for HUD to complete the Environmental Assessment and Complete Findings for the Related Laws (HUD-4128). This includes any documentation that was required as a result of findings made during Pre-Application processing.

B. Lender's Responsibilities:

1. The MAP Lender's appraiser will complete an appraisal establishing the Replacement Cost for the project utilizing the cost approaches in accordance with requirements found in Section 7.4. Furthermore, the appraisal will update the HUD-92273 and 92274 analyses provided in the Pre-Application.
2. The Lender's appraiser is also required to determine the "warranted price of the land" for new construction projects and the "As Is" value of the property for substantial rehabilitation projects in accordance with instructions in Section 7.12. In addition, for substantial rehabilitation projects, the Lender's appraiser must also determine the "value fully improved" of the project site.
3. The MAP Lender will forward information prepared by its cost analyst and any soft-cost and land cost information provided by the sponsor to the Lender's appraiser for assistance in the calculation of the total replacement cost. The Lender will compare his estimate of the total replacement cost with the mortgagor's amount.
4. The Lender's appraiser is to prepare certain sections of the Rental Housing Project Income Analysis and Appraisal, Form HUD-92264, found in the MAP Forms Book, in accordance with specific instructions found in MAP Forms Book, for the type of project proposed. Certain sections are solely the responsibility of the appraiser and others are done in cooperation with the lender's architect, cost analyst, and mortgage credit analyst.
5. Principal HUD-92664 items to be calculated by the Lender's appraiser include:
 - a. Market rents and estimated income
 - b. Estimated total operating expenses
 - c. Total estimated replacement cost of the project
 - d. "Warranted Price of the Land" for new construction projects and the "As Is" value for substantial rehabilitation projects
 - e. Estimate of operating deficit and replacement reserve
 - f. Estimate Remaining Economic Life (See Section 7.4 A.7)
 - g. Estimate of Interest during Construction (line 53 in section g of form HUD 92264), to be calculated as the greater of:

- (1) By formula. The amount of the mortgage multiplied by 0.5, multiplied by construction interest rate and multiplied by construction years. (Construction Years is the construction time in months from line 52 in section G of the form HUD 92264 plus 2 months, then divided by 12)
 - (2) Lenders estimate (optional). The Lenders estimate of interest during construction shall be documented with a pro-forma draw schedule or equivalent, subject to review by HUD processing staff.
6. The Lender must provide written explanations in the underwriter's narrative of any major changes to key project elements from those set at the pre-application stage.
 7. The data provided in the Lender's HUD-92013 and HUD-92264 must be consistent. Moreover, any inconsistency between the data reported on the HUD-92264 prepared by the Lender's appraiser and the Lender's HUD-92264 must be explained in the Lender's Underwriting Summary.

C. HUD Review:

1. The Lender will submit the Exhibits listed in Section 7.10.A to HUD.
2. The HUD appraiser will perform a thorough technical review of the appraisal submitted for the project, making sure that it meets the requirements of Section 7.5 including all USPAP requirements.
3. In accordance with Chapter 9, the HUD appraiser will complete Form HUD-4128 and the Sample Field Notes Checklist.
4. The HUD appraiser must review and approve each of the following exhibits:
 - a. Rental Housing Project Income Analysis and Appraisal, HUD-92264
 - b. Estimates of Market Rent by Comparison, HUD-92273 (updated)
 - c. Operating Expenses Worksheet, HUD-92274 (updated)
 - d. Appraiser's report, Supplemental to Project Analysis, HUD-92264-A

Within these forms, the HUD review appraiser must focus on and approve, reject, or approve with required modifications of major items including the estimated income, the total operating expenses, the total estimated replacement cost, the "Warranted Price of the Land" or the "As Is" value as appropriate, and the maximum insurable mortgage.

5. The HUD review appraiser will issue a written report (Appendix 7) containing recommendations and forward a copy to the HUD Team Leader.
6. The HUD review appraiser will review the Lender's Underwriting Summary, including justifications of discrepancies between the Lender and the Lender's appraiser's conclusions.

7.12

Firm Commitment Processing for Section 223(f) and Section 231 (Existing)

A. Exhibits:

1. Application for Multifamily Housing Project, Form HUD-92013
2. Location map

3. Evidence of permissive zoning
4. Evidence of site control (deed, purchase agreement, option)
5. Evidence of last arms-length transaction and price
6. Phase I Environmental Site Assessment (ESA) with a narrative environment report. A Phase II Environmental Site Assessment must also be submitted, should the Phase I Assessment disclose a need for further study. This requirement applies to all 223(f) programs and 202 (202/223(f)). All environmental assessments should identify the United States Department of Housing and Urban Development as an authorized user of the report(s).
7. Self Contained Appraisal
8. Rental Housing Project Income Analysis and Appraisal, HUD-92264
9. Supplement to Project Analysis, HUD-92264-A
10. Estimates of Market Rent by Comparison, HUD-92273
11. Operating Expenses Analysis Worksheet, HUD-92274
12. Balance sheets and operating statements in accordance with Section 7.8.B.
13. Rent roll of the subject property
14. Project Capital Needs Assessment (See Appendix 5H)

B. Lender's responsibilities:

1. The Underwriting Summary must demonstrate that the MAP underwriter performed adequate due diligence in reviewing the appraisal. There needs to be a thorough discussion by the MAP Underwriter of the appraiser's market analysis with a comparison made to the conclusions from the market study, in cases where a separate market study is required. There must also be a full discussion by the MAP Underwriter of the approaches to value and the appraiser's reconciliation and value conclusion.

NOTE: The lender must state any reasons for disagreement with the appraisal report. The lender may also use a lower value than that indicated in the appraisal report in underwriting the loan. However, the lender shall never use a higher value than that indicated by the appraiser.

2. The MAP Lender's appraiser will complete an appraisal of the property establishing market value utilizing the cost, income, and market approaches in accordance with requirements found in Section 7.4. The Cost Approach may be eliminated at the discretion of the appraiser for subjects that are ten or more years old. However an estimate of the land value is still required.
3. The Lender's appraiser participates in the inspection of the property with the Lender's Needs Assessor as described in Appendix 5H. The appraiser considers the eligibility of the project, checks the project occupancy level, and verifies the owner's rent roll during the inspection process. When the appraiser established that the owner's rent roll is correct, the actual occupancy, based on the owner's rent roll, is entered in the Remarks Section of form HUD-92264. The appraiser must also determine whether the apartments are furnished or unfurnished.
4. The Lender's appraiser will analyze the property for acceptability in accordance with Section 7.9 utilizing the prepared appraisal.
5. The MAP Lender will have the Phase I ESA and narrative report prepared in accordance with Chapter 9. All environmental assessments should identify the United States Department of Housing and Urban Development as an authorized user of the report(s).
6. The Lender's appraiser will complete HUD-92273, Estimate of Market Rents, utilizing the instruction found in the MAP Forms Book. The Lender's appraiser will determine project rents and estimated rental income in accordance with Section 7.7, utilizing HUD-92273, the appraisal and the operating history of the property (rent roll and financial statements).
7. The Lender's appraiser will complete HUD-92274, Operating Expense Analysis Worksheet, utilizing the instruction found in the MAP Forms Book. The appraiser will determine operating expenses for the property in accordance with Section 7.8, utilizing HUD-92274 and the operating history of the property (financial statements).

8. The Lender's appraiser is to prepare certain sections of the Rental Housing Project Income Analysis and Appraisal, HUD-92264), in accordance with instruction found in the MAP Forms Book for the type of project proposed. Certain sections are solely the responsibility of the appraiser, and others are done in coordination with the Lender's architect, and cost analyst.
9. Principal HUD-92264 items to be calculated by the Lender's appraiser include:
 - a. Market rents and estimated income
 - b. Estimated total operating expenses
 - c. Total estimated replacement cost
 - d. "Warranted Price of the Land"
 - e. Market or Investment value of the project
 - f. Estimate of operating deficit and replacement reserve
 - g. Estimated occupancy rate. Note the actual rate is noted in the appraisal report. Underwritten physical occupancy is limited to 93% for market rate, tax credit or other projects with less than 95% project based rental assistance.
 - h. Remaining Economic Life - (See Section 7.6.A.7)
10. The data provided in the Lender's HUD-92013 and HUD-92264 must be consistent. Moreover, any inconsistency between the data reported on the HUD-92264 prepared by the Lender's appraiser and the Lender's HUD-92264 must be explained in the Lender's Underwriting Summary.
11. The Lender's appraiser will provide in the Remarks Section of HUD-92264 the following:
 - a. The appraiser's statement of actual occupancy, based on the owner's rent roll.
 - b. The required amount of initial deposit into the Replacement Reserve Fund as estimated in accordance with Section 7.15.
 - c. The estimated cost of required repairs as provided in the inspection report.
 - d. The estimated amounts for legal, organizational (if applicable) and title and recording expenses based on the maximum insurable 223(f) loan.

C. HUD review:

1. The Lender will submit the Exhibits listed in Section 7.12.A to HUD.
2. The HUD appraiser will perform a thorough technical review of the appraisal submitted for the project, making sure that it meets the requirements of Section 7.5 including all USPAP requirements.
3. The HUD appraiser will inspect the subject site and as many of the comparables as feasible, that were supplied by the Lender's appraiser. At this visit, the HUD appraiser will also review the Mortgagor's proposed list of critical and non-critical repairs and provide an opinion of the acceptability of the list based upon the HUD appraiser's potentially limited knowledge of construction. The HUD appraiser may consult with a HUD construction analyst when formulating the opinion.

4. In accordance with Chapter 9, the HUD appraiser will complete Part A of HUD-4128.
The HUD appraiser will review the recommendations of the HUD architectural analyst and the HUD-92264. The appraiser will review property characteristics for compliance to requirements found in Section 7.9 of this chapter. Based on these reviews and the environmental analysis, the HUD appraiser will make a recommendation of site acceptability.
5. The HUD appraiser must review and approve each of the following Exhibits:
 - a. Rental Housing Project Income Analysis and Appraisal, HUD-92264
 - b. Estimate of Market Rent by Comparison, HUD-92273
 - d. Operating Expenses Worksheet, HUD-92274Within these forms, the HUD review appraiser must focus on and approve, reject, or approve with required modifications of major items including the estimated income, the total operating expenses, the total estimated replacement cost, the estimated remaining economic life, the maximum insurable mortgage, and the market value of the project.
6. The HUD appraiser will review the Lender's Underwriting Summary for justifications of discrepancies between the Lender and Lender's appraiser's conclusions.
7. The HUD appraiser will review the Lender's Underwriting Summary to determine if the Lender's underwriter carried out a "due diligence" review of the Lender's appraisal.
8. The HUD appraiser will issue a written report containing recommendations and forward a copy to the HUD Team Leader, Appendix 7.

7.13

Substantial Rehabilitation Processing for Sections 220 and 221(d)(3) and 221(d)(4)

- A. In general, a substantial rehabilitation project is processed in accordance with the instructions found in Sections 7.10 and 7.11, except as noted below.
- B. Processing of HUD-92264: Form HUD-92264 is completed in accordance with basic valuation instructions for Sections 221(d) and 220 processing in Section 7.10, with the following modifications:
 1. "As Is" Value. Development of the "As Is" value will be in accordance with the pertinent requirements of Standards 1 and 2 and the applicable approaches to value. A supplemental HUD 92264 is no longer required.
 2. The HUD-92273 and HUD-92274 analysis used to support the income and expenses on the HUD-92264 will reflect the conditions that exist after substantial rehabilitation has taken place
 3. A value for the land without improvements must be estimated and entered using the analysis grid in Section H of the HUD 92264.
 4. The "as is" value and the value of the land without improvements must be entered in Section "O" (Remarks) of the HUD 92264.
- C. Applicable Approaches - "As Is" Value in Multifamily Substantial Rehabilitation: The estimate of "As Is" value of the property before rehabilitation should be estimated by the direct market comparison approach and the income approach to value. The "As Is" value by the residual approach can be used in where there is a lack of market sales. The Market Value by the market comparison approach will be based upon market prices for comparable properties in similar

condition to the project being appraised. For example, if comparable sale properties in similar condition are available at \$4,000 per unit, there is no justification for finding a value "As Is" in an amount substantially in excess of \$4,000 per unit. The income approach may not be feasible for the valuation of properties in extremely poor condition, mostly or entirely vacant, boarded up or abandoned for an extended period to time.

D. Valuation Processing:

1. Find the market value of the property "As Is". Complete the Location and Description of the Property, Information concerning Land or Property, Estimate of Income, Equipment and Services Provided in Rent, Estimate of Annual Expenses, Income Computations, and Income Approach to Value, and Sales Comparison Approach to Value within the self-contained report. If the project involves rehabilitation and new construction with additional land to be added, also complete a land appraisal for that portion of the land to be added for new construction.
2. Use the Replacement Cost by Formula, Rehab Projects, with or without BSPRA, found in the MAP Forms Book to find the total project cost (summation estimate) using the market value "As Is" of the property, and the rehabilitation cost estimate furnished by the cost analyst, plus carrying charges and financing.
3. Complete HUD-92264. In Section G of that form, the market "As Is" value of the property before rehabilitation will be shown on the line titled "As Is" value of property."
4. "As Is" value of property acquired as a leasehold estate. Instructions for limiting the "As Is" value of property before rehabilitation, when that property is acquired as a leasehold estate, are to be found in Ground Leases, Section 7.16.
5. To find the project mortgage amount for Section 220 and Section 221, use the lower of Criteria 1, 3, 4, or 5 on HUD-92264-A. Estimate the "As Is" value of the property before rehabilitation. Then, add the total for all improvements, plus soft costs to the AS-IS Value to obtain the sum of the above costs. Afterwards, multiply the sum of the project costs listed above by 90 percent based upon Criterion 3 to obtain the maximum project mortgage amount. Under the Section 221(d) (3) program for nonprofit mortgagors, multiply 100 percent against the sum of the project's cost.

E. Contingency reserves. For the purpose of provision for unanticipated costs inherent in the rehabilitation of older structures, there will normally be included in the mortgage amount a reserve for contingencies. This reserve is based on the percentage of estimated rehabilitation cost without fees (the sum of the total land improvements, total structures and general requirements). This percent may range between 10 percent and 15 percent, depending upon the job conditions, the experience and financial ability of the sponsor, the mortgagor and contractor. In determining the amount of the contingency reserve, judgment must be made on whether the contractor's bid already contains a reserve for contingencies. This percentage, determined by the cost analyst, is included as a separate line item in the estimate of replacement cost on HUD-92264.

F. Interest during construction. Interest during construction (line 53 in section G of the form HUD 92264) will be calculated as the greater of:

1. By formula. The amount of the mortgage multiplied by 50%, multiplied by construction interest rate and multiplied by construction years. (Construction Years is the construction time in months from line 52 in section G of the form HUD 92264 plus 2 months, then divided by 12).

2. Lenders estimate (optional). The Lenders estimate of interest during construction shall be documented with a pro-forma draw schedule or equivalent, subject to review by HUD processing staff.

- G. Inspection fee. The inspection fee is calculated as half of one percent (0.5%) of the loan amount when the project involves new construction. For substantial rehabilitation projects, the inspection fee is calculated as the sum of Total for All Improvements (plus BSPRA, if applicable), rounded to the next higher \$100, times .5 percent.
- H. Offsite costs. If there are any offsite costs associated with the rehabilitation, enter them as a line item in the Estimated Replacement Cost. This separate entry is necessary in rehabilitation processing, since the "As Is" value does not include offsite cost requirements.
- I. Rehabilitation cost not attributable to residential use. This entry must be completed for all rehabilitation projects. This cost is prepared on Rehabilitation Cost Not Attributable to Residential Use, found in The MAP Book. This cost (line 8) is transferred to line 4b under Criterion 4, Amount Based on Limitations per Family Unit, HUD-92264A.
- J. Developer's Fee when applicable. HUD will include in the estimated replacement cost of a project a nonprofit developer's fee. This fee is in addition to the legal, organizational and audit fees normally included in the estimated replacement cost of a project. NOTE: These instructions do not apply to the refinancing of Section 202/811 projects.
1. The fee will be based on a sliding scale at eight percent of the mortgage, but not less than \$40,000 or more than \$400,000.
 2. Exceptions:
 - a. For mortgages in excess of \$5,000,000 increase the maximum fee to provide an additional 2 percent based on that portion of the mortgage that is in excess of \$5,000,000.
 - b. At the option of the nonprofit sponsor/mortgagor, the fee included in the replacement cost may be reduced.
 3. Part or the entire fee may be used to pay for transactional costs related to developing the subject project including but not limited to:
 - a. Reduction of the estimated closing costs of the project
 - b. Staff salaries
 - c. Nonprofit working capital deposit
 - d. Relocation expenses
 - e. Operating deficit escrow
 - f. Financing fees over and above the 3.5% included in the estimated replacement cost of the project;
 - g. Environmental studies
 - h. Housing Consultant services provided by either in-house staff or contractor.
 4. Funds not used to meet the estimated cash requirements of the project will be released to the nonprofit based on a percentage of completion method.

K. Items no longer included in the Estimated Replacement Cost of a Project. HUD will no longer

include in the estimated replacement cost of a project; an Allowance to Make Project Operational (AMPO) and an amount for Housing Consultant services except as part of the Developers Fee noted above in Section J.

7.14

Calculating Operating Deficits

- A. In general, estimate the operating deficit, if any, in the early years. A project which cannot rent-up in the first years must be carefully examined from a feasibility standpoint. On the other hand, it takes time to move tenants into a large project, and it is almost inevitable that the average overall occupancy percentage for the first year will be something less than the break-even percentage. When it is anticipated that the entire project net income will not be available during the initial rent-up period, the Lender's appraiser must estimate the anticipated project operating deficit, utilizing the following steps:
1. Estimate the total project expenses and add the debt service requirement (including principal, interest and M.I.P.). This total is divided by the potential gross income for the project. The resultant ratio is the break-even occupancy level. Multiply that percentage times the total project units to obtain the number of units required for break-even occupancy. (A fraction of a unit is rounded up).
 2. Afterwards, estimate the total number of units expected to be occupied at the time of project endorsement. The difference between the total units required for break-even occupancy and those occupied units at the time of project endorsement represent the total number of units that must be rented in order to reach a break-even occupancy level.
 3. The appraiser must then make an estimate of the likely rate of absorption of the available units. The selected rate must take into account the current and proposed supply of housing units in the subject's market and must be balanced against demographic demand considerations. The absorption or lease-up rate must be supported by comparison with similar project's historic rates of absorption during their lease-up period whenever this comparison can be made. The number of units to be absorbed, divided by the monthly absorption rate, will yield the total number of months of the entire operating deficit period.
 - a. Absorption Period. The Absorption Period is the period of time necessary for a newly constructed or renovated property to achieve the stabilized level of occupancy. The absorption period begins when the first certificate of occupancy is issued and ends when the last unit to reach the stabilized level of occupancy has a signed lease. This assumes a typical pre-marketing period, prior to the issuance of the certificate of occupancy, of about three to six months. The month that leasing is assumed to begin should accompany all absorption estimates. It is important to consider that the absorption of restricted/low-income units may be different, depending on the differential in rent between low-income rents and market rents, and the number of income-qualified potential tenants.
 - b. Maximum Allowable Absorption Period. Generally, HUD has allowed absorption periods up to 24 months. Due to volatility and weakness in the real estate markets, the absorption period used in estimating market demand for the proposed number of units

will now be restricted to 18 months. Larger projects may phase additional units under a separate application for mortgage insurance (e.g. under Section 241(a)). An exception to the 18-month limitation on the absorption period may be considered by the Multifamily Hub Director for large high-rise buildings. Such projects will be evaluated based on their own merit and may require a larger initial operating reserve to insure against slower than anticipated absorption.

- c. Absorption Rate. The Absorption Rate is the average number of units rented each month during the absorption period.
4. Because the deficit period can begin at certificate of occupancy, continue through the cost certification phase, and run into the amortization phase, there are three distinct expense Intervals to consider during the total deficit period. Note that not every project will require using all three intervals.

Interval 1 spans the period of time between certificate of occupancy and the end of the construction period/cost certification period. (Note that the construction period is defined as construction time plus two months for cost certification purposes). This will be an optional interval, because some projects may have the same certificate of occupancy date and construction completion date and thus would not need an Interval 1. When calculating expenses for this Interval, there must be no debt service included as an expense. The mortgage interest for this interval is included in the mortgage in Section G Line 53 "Construction Interest". Replacement Reserves and Ground rent are not to be included in Interval 1. The MAP Guide, at Section 7.16 G, requires ground rent during the construction period to be included in the mortgage. This interval must only include the appraiser's estimate of all of the applicable operating and leasing expenses for each month (period) in this interval.

Interval 2 begins at the end of the construction period/cost certification process (construction time plus two months) and ends at the beginning of amortization. This period can be no greater than 2 months and is also an optional interval. (Map Guide Chapter 8, Section 8.5 A states that amortization must begin "no later than 4 months after construction completion for insurance of advances and first day of second month after final endorsement for insurance of completion cases"). If amortization begins at the end of the construction period, this interval will not be necessary. Debt service must include payment for interest and MIP, but not amortization, as the beginning of amortization signals the beginning of Interval 3. (Section G Line 53 of the HUD 92264 includes mortgage interest for the construction period plus two months. If amortization is deferred until 4 months after construction completion, there will be two months of unaccounted-for interest and MIP that must be included in the IOD). Ground rent must be included if the property is a leasehold. (Only ground rent during construction can be included in the mortgage, this Interval begins after construction completion so ground rent must be included if there is a ground lease). Replacement reserves are not included in Interval 2. This interval must include the appraiser's estimate of applicable operating expenses for each month (period).

Interval 3 begins at the beginning of amortization. Amortized debt service is mandatory in this Interval, and must include payment to principle and interest and MIP. Ground rent, if applicable, is also mandatory in interval 3. Replacement reserves also are mandatory in Interval 3. This interval must include the appraiser's estimate of applicable operating expenses for each month (period). Interval 3 must end when NOI becomes positive.

5. Note that operating deficits can occur before and after the start of amortization. The operating deficit calculation for the first interval must begin at the point the Certificate of Occupancy is secured.
 6. If the dollar debt service for a period is greater than the net income for that period, the difference represents the estimate of the operating deficit. One period of positive income does not cancel a prior period of income deficiency.
 7. The operating deficit represents the total of all cumulative losses projected to occur before the project “breaks even” and produces a positive cash flow to the equity position. These losses may not be offset by intermittent periods of positive cash flow.
- B. Where commercial facilities are included in the project, a separate analysis will be made of the effect that the commercial operation will have on the project expense estimate. A separate operating deficit estimate of income loss for commercial rent-up will then be made. The appraiser must insure that expenses included in the residential deficit estimate are not duplicated in the commercial space deficit estimate so as to unfairly penalize the property. The commercial space deficit is then added to the residential operating income deficit to determine the total deficit escrow that will be necessary. It must be noted that positive income attributable to the commercial space during the deficit period does not offset the residential operating deficit requirements.

A. DEFINITIONS. When used in this section, the words and phrases below are defined as follows:

1. Fee Simple Estate. This represents the entire ownership, from beneath the soil to the air above, enduring by inheritance and, indefinitely into the future. However, governmental limitations to the fee simple estate include taxation, condemnation, and police power (the power to regulate for the general good). Subject to these limitations, the owner of a fee simple estate may use the property and may exclude others from its use; she/he may dispose of the property by sale or by deeding it to another as a gift, or by allowing it to pass to an heir at his/her death including its bequest in the owner's will. The owner may also retain his/her ownership while allowing another person (a tenant) to use the property for a certain number of months or years in return for the payment of money (rent).
2. Lease. A lease is a contract between an owner (the lessor) and a tenant (the lessee) which contains a written agreement of the conditions under which the lessor transfers the use of real property to the lessee in return for lease payments (or rent.)
3. Ground Lease. The term ground lease is frequently used when a lessor leases an unimproved site to a lessee long enough (in years) to enable the lessee to construct a building on the leased site.
4. Ground Rent. The payments on a ground lease are frequently called ground rent, and must bear a reasonable relationship to the value of the site "As Is" (before construction of on-site or off-site improvements).
5. Leasehold Estate. The interest of the lessee (user or tenant) under a ground lease for a term of years is called a leasehold estate. When the term of the lease expires, all rights to possession and use revert back to the lessor/fee simple owner and the leasehold estate terminates.
6. The Leased Fee. The interest of the lessor/fee simple owner during the period when the property is under lease.
7. In computing payments due under the lease, the terms "gross collections," "operating expenses and taxes," "net income before debt service payments" and "net cash flow" shall be defined as follows:
 - a. Gross collections (or effective gross income) shall mean the annual amount collected from all sources, less refunds.
 - b. Operating expenses and taxes shall be composed of items of operating expense and taxes in accord with generally accepted accounting principles. However, for lease payment computations, taxes shall not include income taxes, and operating expenses shall not include interest charges, or charges or allowances for depreciation of real or personal property, or amortization of financing expense, or payments to any officer or director of the corporation, unless such payments are for services at the project which are necessary to the operation of the project. Conversely, operating expenses shall include the annual amounts deposited to replacement reserve funds.
 - c. Net income before debt service payments shall mean the annual amount which remains after operating expenses and taxes are subtracted from effective gross income.
 - d. Debt service payments shall be the annual amounts paid to mortgage principal, interest, and mortgage insurance premium.
 - e. Net cash flow shall be the annual amount remaining after debt service payments are

subtracted from net income.

- B. Term of Lease. Leaseholds must conform to the FHA Lease Addendum Form FHA-2070. 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:
1. The legal need for any proposed lease term changes, and
 2. That any term changes are consistent with the following requirements of the Section of the Act under which the project is underwritten:
 - a. Section 207/223(f) and Section 231 sub-rehab. The lease term must satisfy one of the following requirements):
 - (1) Term is 99 years and is renewable, or
 - (2) 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).
 - b. Section 220, 221(d), and 231 (new construction only). The lease term must satisfy one of the following requirements:
 - (1) Term is 99 years and is renewable, or
 - (2) Term has at least 10 years to run after maturity date of the mortgage.
- C. Marketability. The purchaser of a multifamily housing project is typically an investor in a national or regional market of competing investments. The marketability of a rental project is based primarily on an investor's estimate of the present worth of future cash flows. If the ground lease increases the cash flow to equity, most investors will consider marketability enhanced. However, the leasehold estate cannot be considered marketable unless the lease meets the underwriting review requirements described in this section.
- D. Regulation for Leaseholds. HUD regulations state "Reduced mortgage amount - leaseholds. In the event the mortgage is secured by a leasehold estate rather than a fee simple estate, the value or replacement cost of the property described in the mortgage shall be the value or replacement cost of the leasehold estate (as determined by HUD) which shall in all cases be less than the value or replacement cost of the property in fee simple."
- E. Legal Review. The lease must receive both a legal review and MAP Lender underwriting review. Neither of these reviews may be substituted for the other. Legal review, performed by the HUD legal counsel, shall establish that the proposed lease is in conformity with the applicable statute, HUD regulations, Form No. 2070 (the Lease Addendum model form), and applicable provisions of local law. Any substantive deviations from Form 2070 must be to the Assistant General Counsel for Multifamily Mortgage Insurance.
- F. Underwriting Review of Lease at Firm Commitment. In testing the lease payments for acceptability, the appraiser takes the following actions:
1. The appraiser performs a Firm Commitment review to develop the following estimates:
 - a. Market value of land fully improved (in fee simple)
 - b. Warranted price of site fully improved (in fee simple)
 - c. Value of site "As Is" (in fee simple)

- d. Gross income
 - e. Effective gross income
 - f. Total operating expenses and taxes
 - g. Net income
 - h. Replacement cost by formula
(NOTE: The replacement cost formula to be used with leasehold estates will be found in the MAP Form Book.)
 - i. Value of project (in fee simple) if applicable
 - j. Mortgage amount, by completing a valuation trial copy of Form HUD-92264A. (NOTE: The value of the leased fee equals the value of site "As Is" in fee simple, before construction of on-site or off-site improvements.) The HUD-92264A may be completed by the lender.
 - k. Annual debt service payments to principal, interest, and MIP.
 - l. Annual cash flow to equity (after debt service payments but before ground lease payments.)
2. The appraiser analyzes lease provisions that determine the amount of annual lease rental payments (or ground rents). Although it has been administratively determined that certain kinds of ground rents will be permitted that vary with the passage of time, this must be accomplished without weakening the tests which are designed to assure that the position of the mortgagor and of HUD in an insured mortgage secured by a leasehold estate would be no worse than if the property were held in fee.
- a. Some methods of determining variable lease payments are not acceptable as these methods contain the danger of future payments being too burdensome to be made without default in mortgage payments. Examples of unacceptable methods of determining variable ground rents are:
 - (1) A graduated schedule of future increases on a lump sum year-by-year basis.
 - (2) COLA increases.
 - (3) Increases based on the results of future appraisals.
 - b. To determine if the initial amounts are within underwriting limitations, ground rents may be computed using any of the following three methods:
 - (1) A fixed percentage of gross collections (or effective gross income). The percentage must remain the same throughout the term of the lease.
 - (2) A fixed percentage of net cash flow to equity (after debt service payments but before lease payments). The percentage must remain the same throughout the term of the lease.
 - (3) A stated dollar amount per year which must remain fixed for at least ten years more than the term of the insured mortgage. (If monthly or quarterly payments are required, these will be converted to annual amounts by the appraiser). When the lease contains more than one method of computing lease payments, it will also indicate whether

the amount to be paid shall be the greatest or the least, or the sum of these amounts. The stated annual dollar amount may be described as a minimum payment.

3. The appraiser estimates the lease payments, using the lump sum annual amounts and percentages contained in the lease provisions, as applied to the estimated annual effective gross income or annual cash flow to equity indicated by the appraisal and on Form HUD-92264. (The estimates are not based on the income which would be available during any period of deficit operation, but must reflect the effective gross income shown on Form HUD-92264 and the corresponding cash flow to equity which result when sustaining occupancy has been reached.)
4. Example: Assume the facts are as shown in the following example:

LAND VALUE

Warranted Price of Land Fully Improved (In Fee Simple).....	\$ 125,000
"As Is" Value of Land (In Fee Simple).....	115,000
Value of Leased Fee.....	115,000

Income and Cash Flow

Estimated Effective Annual Gross Income, All Sources.....	\$ 242,455
Estimated Total Annual Expense (incl. Replace. Res.).....	120,500
Estimated Net Income (before mortgage payments).....	121,955
Annual Mortgage Payments (principal, interest, MIP).....	99,661
Estimated Annual Cash Flow to Equity (before ground rent).....	22,294

Estimated Replacement Cost and Mortgage Amount

Estimated Replacement Cost (or Value) of Project (In Fee Simple).....	\$1,250,000
Estimated Value of the Leased Fee.....	115,000

Estimated Replacement Cost (or Value)

Of Project (leasehold Estate)	1,135,000
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Maximum Mortgage Amount from Form 92264A

(Leasehold Estate) \$1,021,500 (\$1,135,000.00 x .90)

Annual Ground Rent Required

Assume that provisions of the lease require annual lease payments to equal the greatest of the three following calculations:

- a. Three percent (3%) of annual gross collections (\$242,455) = \$7,274;
- b. Twenty percent (20%) of annual net cash flow to equity (\$22,294) = \$4,459
- c. Seven Thousand Dollars (\$7,000.00) per year minimum.

The appraiser notes that the amount of initial ground rent required by the lease is the greatest of these three amounts: 3% of annual gross collections, or \$7,274. This amount is next tested to determine whether it is within permissible limits:

- a. 3% of annual gross collections (\$242,455) = \$7,274
- b. 20% of annual net cash flow (\$22,294) = \$4,459
- c. \$7,000 per year, minimum = \$7,000

The appraiser notes that the amount of initial ground rent required by the lease is the greatest of these three amounts: 3% of annual gross collections, or \$7,274. This amount is next tested to determine whether it is within permissible limits.

5. Test for Acceptability of Variable Lease Payments. In the above example, the appraiser has determined the amount of the initial annual ground rent required by the lease; to be acceptable.

Except for level lease payments described in Section 7.15 F7, the annual ground rents must not exceed the value of the site "As Is" in fee simple (\$115,000) multiplied by 90% of the interest rate of the insured mortgage ($.90 \times .09 = .081$).

The following is an example of Test for Acceptability of Variable Lease Payments:

\$7,274 based on the estimate of annual gross collections (effective gross income) used in the appraisal. Thus $\$115,000 \times .081 = \$9,315$. The ground rent (\$7,274) is less than (\$9,315) the value of the site "As Is" multiplied by 90% of the interest rate of the insured mortgage; therefore, the annual rent is acceptable.

6. Form No. 2070, 207 Lease Addenda. The appraiser also reviews provisions of the lease (other than those concerned with annual lease payments) to determine that they will not restrict the successful operation of the project. In analyzing the lease, the appraiser must keep in mind that the provisions of Form 2070, the 207 Lease Addenda, must be included in, or legally appended to, the lease. The proposed lease must not contain any provisions in conflict with the lease addendum. If the above conditions are met and the annual lease payments required under the lease meet the test for acceptability described above, the appraiser recommends that the lease be accepted.
7. Test for Acceptability of Level Lease Payments. The provisions of the lease may require only payments that are a stated dollar amount per year, and these stated annual ground rent payments must remain fixed for at least 10 years more than the term of the insured mortgage. A lease may require payments that are in accord with the stated dollar amount, but may not require payments of a fixed percentage of gross collections, or a fixed percentage of net cash flow to equity (after mortgage payments but before ground lease payments). In such case, the amount of stated annual ground rent will be acceptable if it does not exceed the value of the site "As Is" multiplied by 100% of the interest rate of the insured mortgage.
8. Processing Single, Up-Front Payment (SUP) Leases. HUD has a longstanding policy of only insuring mortgage proceeds for land that is owned in fee simple. In cases where there is an up-front, single payment ground rent, the 'As-Is' value of the land in fee simple is to be subtracted from the property value in Criterion 3 (Line B-1 identified as "value of the leased fee") and is not to be included in the mortgage. SUP leases are treated as any other leased fee in this regard because they do not include the total bundle of rights that are included in a fee simple case.

G. Ground Rent during Construction. For proposed construction under all sections of the Act, lease payments during construction **MUST** be included in the estimated replacement cost of the project (and also in the certified cost), subject to the following conditions:

1. The period for which ground rent is estimated is the same as that for which interest and

other related charges are calculated, namely, the estimated construction time plus two months.

2. Ground rent during construction is entered in Line G 69 of Form HUD-92264 (currently labeled "Construction Fee.") A remark must be entered in Section H, indicating that the amount in Line G 69 represents Ground Rent during Construction.
3. Ground rent is not to be included in the base on which Section 220, 221(d) Builder and Sponsor Profit and Risk Allowance (BSPRA) is calculated.
4. The annual amount of ground rent during construction may not exceed the test for acceptability of lease payments.

H. Replacement Cost by Formula

A formula that will provide the total project replacement cost and mortgage amount, based on cost for proposed construction where a leasehold estate is involved. This formula provides for Sections of the Act, which use BSPRA and also those without BSPRA. A separate formula is necessary for leasehold properties because the mortgage amount is less than it would be if no ground lease were involved.

I. Value of the Leased Fee

1. The procedures for estimating the value of the leased fee are composed of the following general rule and two exceptions:
 - a. General Rule. Except as provided in subparagraph b below, the value of the leased fee must be estimated to equal the market value of the site "As Is" in fee simple. The value of the leased fee must equal the value of the site "As Is" regardless of whether the ground rent is an escalating amount based on a percentage of gross collections, or cash flow, or whether it is a level stated dollar amount each year.
 - (1) The value of the leased fee, so estimated, is entered in the appropriate space in line K-6, Form HUD-92264.
 - (2) Next, the annual ground rent, based on the lease provisions and estimates of income and expense used in the appraisal is entered in the appropriate space in line K-6, Form HUD-92264.
 - (3) Dividing the ground rent by the value of the leased fee will result in the earning rate indicated by this ground rent. This rate is also entered in line K-6.
 - b. Exception for Leases Containing an Option to Buy. In cases that meet the following conditions, the value of the leased fee may be estimated by capitalizing the ground rent.
 - (1) The lease must give the lessee an option to buy the site in fee simple for a stated purchase price at some time during the term of the lease. This stated purchase price must not exceed the value of the leased fee estimated by capitalization at the time of project review.
 - (2) The annual ground rent required by the lease must be level

payments of a stated dollar amount. The amount of these payments must remain unchanged from the date of mortgage endorsement to at least ten years after the mortgage term.

- (3) The capitalization rate used must be the market capitalization rate for similar investments except that it may never exceed the interest rate of the insured mortgage. The ground rent divided by the capitalization rate results in the estimated value of the leased fee to be entered in line K-6, Form 92264.
- J. Option Price for Assistant Secretary for Housing–Federal Housing Commissioner. The Assistant Secretary - Federal Housing Commissioner’s option price in the lease addendum must reflect the value of the leased fee in Form HUD-92264.
- K. Ground Leased from Public Bodies. Where sites are leased by a public body to a developer for a specific purpose, the procedures outlined in this chapter remain unchanged, except that the "As Is" market value of the site in fee simple (before construction of on-site and off-site improvements) may not exceed the value of the leased fee.
- L. Rehabilitation of an Existing Leasehold Project. When a leasehold estate with existing buildings thereon is to receive an insured mortgage for substantial rehabilitation, Valuation processing will vary from fee simple rehabilitation processing as follows:
1. "As Is" Value of Entire Property, Land, and Buildings
 - a. Tentative "As Is" value of both land and building(s) is made in the usual way by capitalization and by comparison.
 - b. Value of land without building improvements is made by market comparison based on sales of similar sites.
 - c. Acquisition Cost of Buildings. The maximum ground rent is limited by the value of the land without buildings multiplied by 100 percent of the market mortgage interest for level ground rent payments, or multiplied by 90 percent of the market mortgage interest rate for acceptable escalating payments. Since the value of the land without improvements does not include buildings, the cost of the acquisition of the buildings will be whatever added cash amount the buyer pays the seller of the subject property for the buildings, at or before initial closing. A certificate of the separately agreed amount for purchase of the buildings shall be submitted with the application exhibits. In a refinancing rehabilitation loan, which does not involve a buyer and seller, the acquisition cost of the buildings may not exceed the remaining mortgage balance.
 - d. Final "As Is" value of entire property is the lesser of Section 7.15.L.1.a or the sum of Sections 7.15.L.1.b and 7.15.L.1.c.
 2. Value of the Leased Fee. This value will be the amount shown in Section 7.15.L.1.b, Value of Land without Building Improvements.
 3. Term of Ground Lease. The term of the leasehold must comply with Section 7.15 B above.
 4. Value of the Leased Fee. The value of the leased fee is estimated to equal the value of the site in fee without the on-site improvements and is entered on Line K-6 of Form HUD-92264.
 5. Underwriting Review of Lease. The appraiser follows procedures in Section 7.15G to determine whether the annual ground rental is acceptable.

6. Lease Addendum. Form 2070 must be included in, or legally appended to, the lease. The appraiser also reviews provisions of the lease (other than those concerned with annual lease payments) to determine that they will not restrict the successful operation of the project. If the above conditions are met and the annual lease payments meet the test for acceptability, the appraiser recommends that the lease be accepted.
7. Ground Rent during Construction. For rehabilitation under all Sections of the Act, ground rent during rehabilitation MUST be included in the replacement cost in a manner that meets the requirements of Section 7.15 G.
8. Replacement Cost by Formula. A formula that will provide the total project replacement cost and mortgage amount, based on cost for substantial rehabilitation wherein a leasehold estate is involved, is shown in the MAP Forms Book. This formula provides both for sections of the act which use BSPRA and those without BSPRA.

7.16

Tax Abatement Procedures

- A. General Comments and Exceptions.. Tax Abatement is a reduction of property taxes for a specified term by the taxing authority. Properties with an abatement agreement are eligible for additional mortgage funds under certain circumstances. The abatement must normally run with the real estate and not with the type of sponsorship if it is to secure additional mortgage proceeds, otherwise underwriting must include an amount for property taxes even though the present owner or its nonprofit transferee may not be paying them. HUD cannot take the risk that, in case of transfer of the property or assignment of the mortgage in the future, the new owner might lose the tax abatement. Exceptions to these requirements include the following:
 1. If the financing includes low-income housing tax credits (LIHTC) as equity, and if the tax abatement runs with the sponsorship (mortgagor) entity, then the Hub Director may waive the MAP Guide so that the underwriting does not have to include a provision for property taxes to the extent permitted by local law for tax abatement. This exception is justified because of the low loan-to-value mortgages that accompany LIHTC.
 2. Refinancing of direct loans under Section 202 Section 223(f) under any section of the Act where FHA financing can be used with LIHTC. The Appraiser should consult Chapter 3, Sections 3.5, 3.6, & 3.8 to ensure that the correct debt service coverage ratio is being used in calculating the debt service rate in Criterion 5 on HUD-92264-A.
 3. Properties leased from a public body to either a non-profit or for-profit developer, where the property is exempt from taxes. Abatement flows to the leasehold improvements. There is normally a requirement for a percentage of units be set aside as affordable housing and this should be formalized with a land use restriction. Hub directors may grant a waiver, after appropriate review to promote affordable housing.
- B. Long Term Tax Abatement. If the amount of the tax abatement is fixed and runs the entire term of the mortgage, the real estate tax expense reported on the HUD-92264 must be the actual amount of taxes the property will pay. The full amount of the real estate taxes without the abatement must be noted in the remarks section of the HUD-92264. The property will benefit from an increased mortgage amount due to the lower pro-forma operating expenses and an increased NOI estimate.

Note, when the abatement covers the full term of the mortgage, the NOI used for Form HUD 92264-A Criteria 5 may also be processed at the reduced tax amount.

- C. Short Term or Variable Tax Abatement. If the abatement is short term or varied, it may still be used to secure additional mortgage proceeds. The additional mortgage will be the amount that the abated taxes will amortize over the term of the abatement. A special amortization plan must be requested which has debt service payments that are increased by the additional net income generated the agreed term of the abatement.

When processing a short term or varied abatement, the full amount of the property taxes will be estimated and included in the total project expenses on Form HUD 92264 as if there were no abatement. The additional debt service ability resulting from the abatement must be calculated on line I, Criteria 5 of HUD 92264-A.

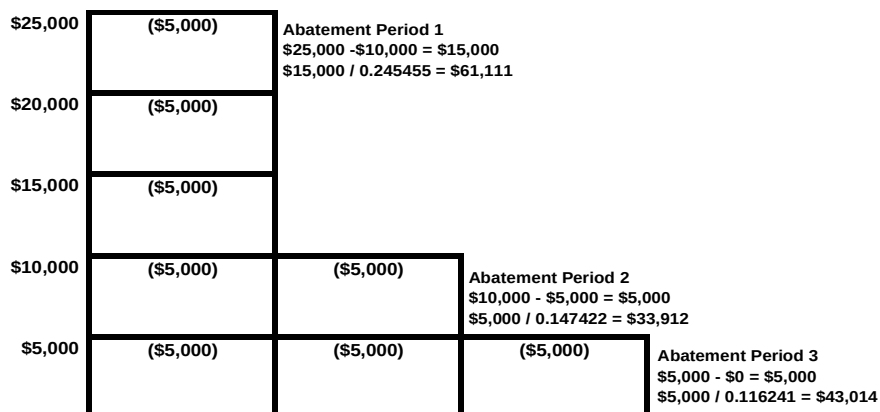
NOTE: If Criteria 5, “Amount Based on Debt Service Ratio” is NOT the controlling criterion; short term or variable abatement cannot be used to secure additional mortgage proceeds. Also, the appraiser must not include value associated with short-term abatement in either the estimate of land value, “as is” value for substantial rehabilitation or the “as repaired” value for existing projects. This may not be included in Criterion 3.

1. Short Term Abatements: Assume that Property A has been awarded a 5-year tax abatement of \$5,000/year. The interest rate on the loan is quoted at 7.5%. The FHA Mortgage Insurance Premium (MIP) is 0.5%. The amount of additional mortgage is calculated by dividing the annual abatement, \$5,000 by the applicable debt service rate (P, I, and MIP). In this example the debt service rate is 0.245455383.

$$\$5,000 / .245455383 = \$20,370$$

Additional mortgage amount. The mortgage amount based upon debt service, Criteria 5 of HUD 92264-A would be increased by \$20,370 and a special amortization schedule would be requested with a debt service payment that is \$5,000/year greater in years 1 through 5.

2. Variable Abatements: Varied tax abatements are a little more complex to quantify, but are essentially calculated in the same manor. Assume that Property B has been awarded a 15-year tax abatement. In years 1 through 5, the abatement is \$25,000; in years 6 through 10 the abatement is \$10,000; and in years 11 through 15 the abated amount is \$5,000. The interest rate on the loan is quoted at 7.5%; MIP is .5%. The amount of additional mortgage is again calculated as the amount that could be fully amortized by the varied payments over the fifteen-year period based on the financing terms as stated. The graph below illustrates the calculation.



When there are two or more abatement amounts and periods, and the amounts decline, the abatement amount for each period may be found by subtracting the abatement amount of the next period. Period 1 will run 5 years, Period 2 will run 10 years, and Period 3 will run 15 years. Because all three periods begin amortization at the same point, or year 0, you must subtract the amount of the abatement for the next period to avoid double counting.

(1) Abatement Period 1

\$25,000 minus \$10,000 (the amount of abatement in period 2) = \$15,000 for 5 years. The debt service rate for a 5 year term at 7.5% interest with 5% MIP is 0.245455383. Dividing \$15,000 by 0.245455383 indicates additional mortgage proceeds of \$61,111 attributable to period 1.

(2) Abatement Period 2

\$10,000 minus \$5,000 (the amount of abatement in period 3) = \$5,000 for 10 years. The debt service rate for a 10 year term at 7.5% interest with 0.5% MIP is 0.147442123. Dividing \$5,000 by 0.147442123 indicates additional mortgage proceeds of \$33,912 attributable to period 2.

(3) Abatement Period 3

\$5,000 minus \$0 (since there are no periods remaining) = \$5,000 for 15 years. The debt service rate for a 15 year term at 7.5% interest with 0.5% MIP is 0.116241483. Dividing \$5,000 by 0.116241483 indicates additional mortgage proceeds of \$43,014 attributable to period 3.

(4) Adding the supportable mortgages from each of the abatement periods results in a total additional supportable mortgage of:

Period 1 = \$ 61,111
Period 2 = \$ 33,912
Period 3 = \$ 43,014
Total = \$138,037

The mortgage amount based upon debt service, or Criteria 5 of HUD 92264-A would be increased by \$138,037 and a special amortization schedule would be requested with a debt service payment that reflects \$25,000 per year in years 1 through 5; \$10,000 in years 6 through 10; and \$5,000 in years 11 through 15.

7.17

Section 8 and LIHTC Processing

A. For Section 223(f). These properties must be evaluated under two scenarios. The “hypothetical market value” of the property without regard to any Section 8 project based subsidies, rent restrictions or LITHC awards must be ascertained; and a debt service analysis that considers all Section 8 project based subsidies and other rent restrictions must be performed. Two independent

Section C rent schedules must be prepared. One is to be a hypothetical market rent estimate and the second must observe all rent restrictions and subsidies.

1. Criteria 3 Market Value: The Appraiser shall ignore the Section 8 contract rents, tax exempt bond restricted rents and/or LIHTC rents tied to the debt financing when determining market value and the income to be capitalized for determination of market value for the purposes of determining Section K, Form HUD-92264, and Criteria 3 Form HUD-92264-A Value. To be consistent, the Appraiser must use a market- based capitalization rate and will assume market rents including repairs in the Income approach to value. Note that the sales comparison approach to value must be completed consistently, without regard to Section 8 or LIHTC awards.
2. Criteria 5 Debt Service Analysis: In calculating net operating income to be used for Criteria 5 Debt Service, rent restrictions must be observed. For the Criteria 5 debt service analysis, the Line 6, Form HUD-92264-T rents shall be used. This applies to projects receiving LIHTC's that combines tax exempt bond financing or market-rate mortgage financing.
3. Form 92264T for LIHTC projects without Section 8: Follow existing form instructions. Processing will be based upon the lesser of Lines 1, 4 or 5.
4. Form 92264T for Section 8 Project Based Assistance without LIHTC's:
 - a. Enter the market rent by comparison on Line 1.
 - b. Enter Personal Benefit Expenses on Line 2.
 - c. Line 3 is Not Applicable
 - d. Line 4 is Not Applicable
 - e. Enter the Project Based Section 8 Contract Rent on Line 5.
 - f. Subtract Line 2 from Line 5 (if applicable)
 - g. Process using the lesser of Line 1 or Line 5.
5. For Section 8 Project Based Assistance with LIHTC's

The LIHTC rent is recorded but not used as a limiting criterion because the total income to the project is the LIHTC rent combined with the Section 8 rent, so that ultimately the amount of rental income to the project will be the Project Based Section 8 rent. Example is as follows.

2 Bedroom Section 8 Contract Rent	\$850/Month
2 Bedroom LIHTC Rent limit	\$350/Month
Tenant's Rent Obligation to Project:	\$350/Month
Section 8 Payment to Project:	\$500/Month
Total Income to Project	\$850/Mont

This information should be noted in the self-contained appraisal report and in the remarks section of the form HUD 92264. A 92264T does not have to be completed in cases where there is Section 8 Project Based Assistance with LIHTCs

- B. Income. If additional fees for amenities related to the project are mandatory for all tenants, the mandatory fee income from restricted units must be excluded from the calculation of net

income. The mandatory fee income from non-restricted units may be included if these fees for these amenities are indicated by the market. This must be explained in remarks Section of form HUD-92264.

C. Expenses: Properties with tax credit restricted units will commonly have a higher operating expense ratio per unit than market rate properties. This added expense may be due to increased administrative costs for tax credit monitoring, performing tenant income certifications and staffing to operate on-site resident services. Estimating operating expenses for projects that are to be funded through the sale of LIHTCs requires the analysis of LIHTC comparables if available, and consultation with other experts (i.e. appraisers and property managers) in the context of current market conditions and should consider the size of the project and unit mix. Utility expenses in LIHTC projects may be estimated by the analysis of actual costs supplied by the developer, the utility company or by use of the Section 8 utility allowances.

1. If the property has the same expense needs under LIHTC or Project Based Section 8 Operation as it would under market rate operation, enter expenses as you would normally.
2. If a property has different expense needs as a subsidized property versus if it were to be operated as a market-rate based property, **the expenses used for Criteria 3 must be market rate expenses and the expenses used for Criteria 5 debt service shall be the actual expenses under its' proposed usage.** This will insure that the Criteria 5 - debt service analysis of the HUD 92264a is calculated based on the true estimate of rent restricted NOI for the property.

D. Sections 220 and 221(d) Site Value and "As Is" Value: The fact that LIHTCs or Section 8 project based subsidies are present shall not affect the appraiser's estimate of Warranted Price of land in new construction or the "As Is" value in substantial rehabilitation cases.

E. Income Limits. The review appraiser must ascertain that the correct income limits are employed in calculating the maximum LIHTC maximum rents and in completing the form HUD 92264-T. **The Housing Economic Recovery Act of 2008 (HERA)** modifies HUD's income limit methodology for calendar years after 2008 to require the Department to increase applicable area median incomes by the amount area median incomes rise, even if the HUD-determined area median incomes would be frozen under the Department's 2007 and 2008 income limit methodology. For LIHTC, HERA defines area median income in rural areas as the greater of the area median income and the national non-metropolitan median income, effective for income determinations made after date of HERA enactment, applicable only to 9 percent Tax Credit development.

Chapter 8

SUMMARY OF MAJOR CHANGES IN CHAPTER 8 OF THE MAP GUIDE MORTGAGE CREDIT ANALYSIS

This memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>.

The originally published MAP Guide is a compilation of existing HUD M/F processing handbooks (**4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance**; 4425.2 Rev. 2 Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement; 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance; 4450.1 Rev. 1 Cost Estimation for Project Mortgage Insurance; 4460.1 Rev 1 Architectural Analysis and Inspection for Project Mortgage Insurance; 4470.2 Rev 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured; and Section 202/811 Multifamily Projects) Mortgage Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/officer/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgage Letters from April 2002 through April 2010, and the Housing Economic Recovery Act (HERA) 2008. Additionally all forms used in the underwriting of an insured multifamily mortgage have OMB approval.

Specific Chapter 8 revisions in the new release:

- New to Section 8.2, is Form HUD-2530, Previous Participant Certification or the Active Partner Performance System (APPS) Participant Certification page, which is now included as an exhibit in the pre-application stage of processing. Previously only HUD-2530 was submitted at the Firm Commitment processing stage. Now that APPS is an electronic filing system it allows HUD's business partners to manage their company and individual participation information and transmit this information via the internet.
- Clarification to Section 8.3.B.5, confirms the use of Fannie Mae Form FNMA-1006, Verification of Deposit, as an acceptable application exhibit. Previously we did not identify the form number or that the Form was from Fannie Mae.
- Major changes were made to Section 8.3.D, "Identifying the Principals." The substantial expansion of this section defines various forms of public and private entities as principals, per regulation. Specifically we clarified that the identity of managing members and members of limited liability companies (LLCs) is as compared to a general partner and limited partner respectively. The regulation ownership interest percentage requirement for LLCs was changed

from 10 percent to 25 percent to be in line with the ownership percentage of a general partner and a limited partner. We clarified that the previous participation certification (2530), credit and financial disclosures apply to all forms of principal types in this section.

- Section 8.4.C.13 The Department has increased in the number of applications that contain Low Income Housing Tax Credits. It has also become apparent to the Housing Development that Historic Tax Credits are being acquired for the rehabilitation of older historic buildings. So as part of the financial investigation we are also now requiring a Letter of Commitment for Historic Tax Credits.
- Section 8.8.D.6.a major controversy surrounded the proper way to determine what is and is not recognized as recent indebtedness for those projects being refinanced under the Section 223(f) program. However, simply defining recent indebtedness as any debt incurred up to one year before submitting an application for mortgage insurance, lenders were allowing mortgagors to creating debt that was allowed to age for 12 months without being touched. After which the owner would submit an application that disclosed on its financial statements or sources and uses statements indebtedness that was not a direct result of the refinanced mortgage transaction.
- 8.9.B.1 & B.2 secondary financing under the Section 223(f) program was modified to explain its use to cover 100 percent of equity when secondary financing is from a government source. When secondary financing is from a private source it can cover a portion of the equity.
- New Section 8.10.A.4 was added to update firm commitment process instructions to consider the use of syndication proceeds from the sale of Low Income Housing Tax Credits and Historical Tax Credits.
- New Section 8.10.B.3 was added to bring MAP Lenders attention to the subject of undisclosed grants and/ or loans that mortgagors may not have disclosed to the MAP Lender at the earliest stage of processing, pre-application or firm commitment.
- Section 8.11 subsidy layering/tax credits was added to the MAP Guide to announce two new amendments in our processing procedures. The Housing and Economic Recovery Act of 2008, for multifamily mortgages, removed the requirement of subsidy layering reviews and modified the type of projects that do not need to cost certified.
- Section 8.15.C.5 was added to specify when there is any excess income from the premium of tax-exempt bonds in Section 223(f) transactions the excess income is deposited into the projects replacement reserve account.
- Risk mitigation underwriting changes to debt service coverage, loan to value, strengthened credit and financial analysis, i.e. key principals must meet a threshold of \$250,000 before submitting an application.

Mortgage Credit Underwriting and Processing Requirements

8.1

Qualifications and Duties

A. Lender Qualifications

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

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

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

- (1) Initial distribution of mortgage proceeds into various accounts and maintains a record of control and disbursement thereafter. This includes the preparation of Form HUD-

2283, Financial Requirements for Closing, based on information contained in the Firm Commitment and approved closing documents.

- (2) Determine construction cost (as approved by the HUD inspector), architect fees and carrying charges payable under request for advances of multifamily mortgage proceeds, prepare written reasons for modifications as necessary.
- (3) Recommend approval of construction change orders and recommend release of both on-site and off-site escrow funds, citing special requirements or conditions of approval as necessary.

C. Major Duties and Responsibilities of HUD

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

8.2

Pre-application Processing

A. Exhibits

1. HUD-92013 Application for Multi-Family Housing Project
- 2.** HUD-3433, Request for Preliminary Determination as Nonprofit Sponsor and/or Mortgagor and supplemental documentation
- 3.** Form HUD-2530, or Active Partner Performance System (APPS) Participant Certification page (participant signature page with submission id number). Electronic 2530 (E-2530) Participant Certification page may now be included as an exhibit as early as the pre-application stage of processing. Once the pre-application is assigned an FHA number the participant can create the APPS E-2530 Property Submission for HUD's electronic 2530 approval. For

applications that do not require a pre-application stage, the E-2530 Property Submission can begin once the Firm application is assigned an FHA number.

B. Mortgage Credit Duties and Responsibilities of the Lender's Underwriter

1. Determines general and financial acceptability of any proposed nonprofit sponsor/mortgagor in accordance with Section 8.12.

C. Duties of HUD

- 1.** Retrieve the APPS E-2530 Property Submission to perform the electronic 2530 review and approval process.

8.3

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

A. In General

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

1. Identify the mortgagor and its principal or individuals.
2. Analyze the credit worthiness of the principal sponsors, the mortgagor entity, if formed, principals, individuals and the contractor.
3. Analyze the mortgagor and contractors experience record.

4. Determine the financial capability of the mortgagor and the general contractor.

5. Given the increased possibility for borrowers to be in material adverse financial positions as potentially over-leveraged short term debt comes due in the next several years, the Lender's credit review is particularly important. Generally, the Lender and HUD have exercised discretion in the extent of mortgage credit review where the single asset mortgagor entity is fully funded. Because of concerns about the impact of volatile real estate fundamentals, and the lack of liquidity in the commercial real estate financing markets, HUD is emphasizing the need for mortgage credit review by the Lender on all principals and affiliates, whether or not the single asset mortgagor entity is fully funded. The Lender's mortgage credit review must include:

- a. The balance sheets for all principals should, in addition to other relevant schedules, contain a Schedule of Real Estate Owned, and a Schedule of Mortgage Debt is applicable only when the event of mortgage maturity is in the next five (5) years or the property is a troubled asset.
- b. The Lender's mortgage credit review and Firm Commitment submission should address the creditworthiness of all principals, and contain a written analysis of the financial position and contingent liabilities, particularly all mortgage debt with near or intermediate term balloon payments (i.e. within the next 5 years).

- c. The Lender's analysis of the various properties' net operating income, outstanding indebtedness, valuation estimates etc., with details supporting Lender's assessment of the likelihood of successfully refinancing projects with maturing balloon debt, assuming current capital markets conditions and current availability of alternative long term financing sources.
 - d. The Lender's analysis should reconcile the data, and come to a conclusion as to the borrower's creditworthiness. Particular attention should be given to principals with a history or anticipated incidence of adverse credit actions including (but not limited to) bankruptcies, foreclosures, or a pattern of renegotiating debt.
 - e. A financing plan for any shortfall or anticipated lack of available credit should be provided. Both conventional financing and other FHA insured loans should be included in this analysis.
6. The US Patriot Act requires Office of Foreign Assets Control (OFAC)/Terrorism checks and verifications on principals. These checks must be completed and documented prior to Initial Endorsement, whether or not the Lender is a regulated financial institution. OFAC requirements are administered by the Department of the Treasury, and Lenders should refer to Treasury's website <http://www.ustreas.gov/offices/enforcement/ofac>, if they have questions.

B. Exhibits

1. Data in the Application Multifamily Projects, Form HUD-92013 disclosing:
 - a. Type of mortgagor entity.
 - b. Interest rate, costs of issuance (if the project will be financed with tax-exempt or taxable bonds), financing fees and discounts to be charged.
 - c. Names, addresses, telephone numbers and Social Security Numbers (SSN) or Employer Identification Numbers (EIN) for the sponsor, mortgagor, if formed, general contractor, attorney, architect and consultant, if any. NOTE: Providing the SSN/EIN is mandatory for the sponsor, mortgagor and their principals; however, this information is voluntary for all other participants.
 - d. Sources of funds for the mortgagor entity.
2. Current resumes of the sponsor, mortgagor and its key principals, and the general contractor.
3. FORM HUD-2530, Previous Participation Certification or Active Partner Performance System (APPS) Participant Certification, for individuals, organizations and corporations.
4. Form HUD-92013 Supp, listing bank and trade references for all sponsors, the mortgagor, each principal of the mortgagor, and the general contractor along with disclosure of prior legal action, outstanding delinquent Federal debt, and SSN or EIN, whichever is applicable.
5. A FNMA Form 1006, Request for Verification of Deposit, for each bank reference included on Form HUD-92013 Supp.
6. Grant, Loan Commitment, and/or Tax Credit Commitment letter (if applicable).
7. A listing from all sponsors, the mortgagor, all principals of the mortgagor entity and the general contractor of all business concerns in which these entities serve as a:
 - a. general partner;
 - b. limited partner with a 25 percent or more interest;
 - c. stockholder with a 10 percent or more interest; or

- d. corporate officer.
8. A statement whether an identity of interest exists between the mortgagor and the general contractor, and/or architect.
9. Credit reports, current within 30 days of the application date.
10. Evidence of site control (valid option, purchase agreement or documentation proving ownership) and the date of the last arms-length transaction and price.
11. Certifications from the sponsor, the mortgagor entity, each principal and the general contractor, which authorize the release of banking and credit information. A certification similar to the following is required:

"To Whom It May Concern:

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

By: _____ Date _____".

C. Identifying the Borrower and Its Principals

1. There are numerous ways for investors to own an interest in real property. Each of these different forms of ownership provides the investor with different capabilities and limitations in making a profit from the property. No particular form is necessarily ideal; each has certain advantages and disadvantages. Depending on the property and the goals of the investors, one form can be more beneficial than others. Each form of ownership has different effects on income from the property, payment to the investor, tax obligations, and the relationship between the manager and the owner. Identifying the form of ownership helps the underwriter in determining who the likely principals will be in a specific borrower entity. **If the borrower or sponsor has a complex or layered organizational structure, you must review that structure and identify the controlling individual or entity. Confirm that the borrower/ sponsor is legally organized in a manner that meets our requirements for owning and managing a property and consider any difficulties or increase risk that the organizational structure might impose in the event of default of foreclosure.**
2. Principal forms of Property Ownership are:
 - a. sole proprietor;
 - b. general partnership;
 - c. limited partnership;
 - d. corporation, C corporation, S corporation;
 - e. limited liability company; and
 - f.** trusts;
 - g.** nonprofit; and
 - h.** any other public or private entity.

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

D. Identifying the Principals

1. Pursuant to 24 CFR Section 200.215(e), a principal is a public or private entity proposing to participate in a project as a sponsor, owner, prime contractor, etc. The principal's role can be one of actual participation in directing the activities and affairs of the mortgagor entity or involvement in decision-making, or one of inactive participation where an ownership interest has been acquired. All principals must be identified and analyzed based on their credit, experience, and financial histories.

a. Who is a "Principal" for all purposes of 2530, credit and financial investigations?:

(1) Any affiliate of the principals; principals of the mortgagor entity; if the principal is a partnership all general partners and limited partners having a 25 percent or more interest in the partnership. If the principal is a corporation all operating officers, all directors and each stockholder having a 10 percent or more interest in the corporation, or limited partners having 25 percent or more interest in the corporation.

(2) If the principal is a limited liability company (LLC), all managing members and all members having a 25 percent or more interest in the LLC. A member is an owner of the LLC and is similar to a stockholder as in a corporation or a limited partnership. A Manager is a person chosen by the members to manage the LLC, which is similar to a director of a corporation or general partner. A manager can also be a member.

(3) General contractors;

(4) Management agents; (Note: A financial and credit analysis is not required unless they meet the sponsor and owner criteria in Section 8.3 D (1) above.)

(5) Packagers, consultants and other persons or organizations hired: to furnish advisory services in project financing, construction or operation and the related HUD requirements, services may be included to select and negotiate contracts with contractors, architects, attorney or managing agents, secure financing; and

(6) Architects and attorneys who have any interest in the project other than an arms-length fee arrangement for professional services. (Note: Financial and credit analysis are not required unless they meet the sponsor and owner criteria in Section 8.3.D (1) above.)

b. Who is not a "Principal" for purposes of purposes of previous participation review (Form HUD-2530:

(1) Stockholders with less than 10 percent interest in a corporation;

(2) Limited partners with less than 25 percent interest in the partnership;

(3) Attorneys and architects with` only an arms-length fee arrangement for services;

- (4) Minor corporate officers;
- (5) Sub-contractors;
- (6) Public Housing Agencies; and
- (7) Officers of Passive Investors (e.g. pass-through/ shell company, tax credit investor).

c. Real Estate Owned (REO) Schedule. The requirements as detailed in Section 8.4.B applies for those principals who are actively involved in the operating decisions and are significant financial investors. The MAP Lender's Underwriter must determine which principals have control of the single asset entity and property. The Underwriter will need to assess their financial stability and how it will impact the risk to FHA and thus a review of their financial statement notes particularly on the schedule of REO and mortgage debt, if required.

E. The Credit Investigation

1. Lenders require credit reports or credit histories as a means of validating and cross checking information received from the borrower in the financial statements and application forms.
2. Credit reports give a picture of the borrower's payment history and financial interactions with its creditors and allow the underwriter to make sound conclusions about the borrower's credit worthiness. They also allow the Lender to reconcile any significant contradictions between the financial statements and the credit report.
3. A commercial credit report for business or a residential mortgage credit report (RMCR) for individuals current within 30 days of the application acceptance date is required on:
 - a. All Sponsors;
 - b. The mortgagor entity, if formed before submission of application;
 - c. Principals of the mortgagor defined in Section 8.3 D.1.a. (1):
NOTE: If a principal is a business entity (i.e. corporation, partnership, limited partnership) with an operating history, a credit report is required only on the business firm not the owners or tax partners of the firm.
4. Business concerns listed in Section 8.3.B.7 require credit reports on:
 - a. All businesses involving a pending judgment(s), legal action or suit or bankruptcy claim;
 - b.** Ten percent statistical sampling selected by the mortgagee up to a maximum of 10 or any remaining ventures.
5. The general contractor.
6. The housing consultant, as applicable for nonprofit transactions.
7. A credit review of members of public and nonprofit board of directors is not required unless they are also an officer with decision making role over the property.

F. Lender's Review of the Credit Report

1. It is important that all information obtained from credit reports and histories be compared to the financial statements provided by the relevant borrower or principal(s). Any contradictory issues should lead to further inquiry until the evidence shows a consistent and complete picture.

2. Make reasonable inquiries to determine if the applicant or any principal is in default on any Federal debt, i.e., direct loans, HUD insured loans, student loans, Small Business Administration loans, or judgment liens against property for a debt owed by the Federal government.
3. Determine if discrepancies exist between the information included on the financial statement and in the credit report.
4. Investigate any adverse credit information that appears on the credit report or which becomes known because of making inquiries of bank and trade references and to other HUD offices. Require a written explanation of any late payments, actions, judgments or derogatory information.

G. Delinquent Federal Debt:

1. When a delinquent Federal debt exists, the Lender shall include as part of the required application exhibits:
 - a. A detailed written explanation from any applicant or principal with a prior Federal default or claim or whose credit report and financial statements contain conflicting or adverse information.
 - b. A letter from the affected agency, on agency letterhead and signed by an officer, stating the delinquent Federal debt is current or satisfactory arrangements for repayments have been made.
 - c. The Lender's reason(s) for recommendation of the applicant, which may be included in the Lender's report as described in Section 8.17.

H. Trade and Credit References

1. In addition to the credit report, make inquiries of banks and trade references that have been disclosed on the Form HUD-92013 Supp.
2. For bank inquiries, we are now relying on the completed FNMA Form 1006, Request for Verification of Deposit. Obtain verification of deposit for each bank reference listed on HUD-92013 Supp and the participant's financial statements. Such bank references must include a sampling of mortgage payment histories and must confirm the character, business acumen (expertise), and timeliness of the borrower and sponsor in meeting its business obligations.
3. Written inquiries of trade references should include a copy of the certification authorizing the release of credit information.
4. Do not require verifications of deposit on officers of a nonprofit corporation and officers of a profit-motivated corporation that have no ownership interest in the corporation and are not being relied upon for financial capacity. However, a general written inquiry to the bank about their experience with the individual/firm is required.

I. Rejection Because of Unacceptable Credit:

1. Consider the individual/firm, a credit reject if:
 - a. The credit investigation evidences that the principal has a history of not repaying creditors in a timely manner or lack of liquidity.
 - b. Delinquent Federal debt has not been resolved or satisfactory arrangements made for repayment.

- c. There are judgments or actions against the party, which:
 - (1) Could significantly impact upon the financial position of the individual/ firm.
 - (2) Result in a determination that the individual/firm is an unacceptable credit risk.
- d. They are insolvent or are the subject of a pending bankruptcy or insolvency proceeding at the time of application, firm commitment, or at the time of loan closing.
- e. An REO Schedule showing unacceptable contingent liabilities or refinance risk that can destabilize principals.

J. Analyzing the Borrower's and Contractor's Previous Experience:

1. The Lender's underwriter is to evaluate the resume of the principal(s). In doing so, the underwriter will be looking for their experience and qualifications in developing, owning or building similar multifamily properties. They must demonstrate a history of ethical and quality business practices and who have a high degree of responsibility, particularly in the resolution of past problems. The underwriter's review of each real estate and business experience and qualifications must also indicate adherence to an ownership philosophy of maintaining a high quality asset, as evidenced by good physical condition and professional management. Pay particular attention to:
 - a. Type and size of previous projects; assess whether their requisite business experience shows that they are able to operate and manage a multifamily property of the size and complexity of the property throughout the term of the mortgage; assess their handling of adverse circumstances.
 - b. Geographic area of business involvement;
 - c. Length of time served in this capacity; and
 - d. Past roles in multifamily business (i.e. previous participation (APPS), multifamily delinquency and default reporting system, limited denial of participation, etc.).
2. Each resume should demonstrate the level of experience needed to successfully complete the development of the project. Identify new borrower and sponsors whose primary business is not real estate, have little experience or are new to a particular market. In these instances, you must inspect a sample of each borrower's real estate holdings to determine the quality of the assets and management of each borrower's existing portfolio. Explain any identified risks in the existing portfolio.
- 3.** Require the addition of members to the development team if necessary to satisfy experience requirements.
- 4.** For borrowers on a property receiving low income housing tax credits or property receiving other forms of subsidy such as Section 8 assistance, you must ensure that the borrower has demonstrated experience in owning comparable properties.

- K. Principals with greater than \$250,000,000 of outstanding FHA insured debt. The Lender must pay particular attention and additional scrutiny toward cases where principals have greater than \$250,000,000 of outstanding FHA insured debt. Based on the Lender's review of the principal's Schedule of Real Estate Owned, the Lender must identify principals that exceed this \$250,000,000

threshold. Lenders will need HUD Loan Committee pre-approval before such principals or borrowers may apply for additional insurance commitments. The Lender's presentation to the Hub/PC will be reviewed and forwarded to the HUD National Loan Committee and must address the following items:

1. An analysis of the borrower's financial strength, credit history and experience.
2. Account for FHA and conventional debt on the REO schedule
3. An explanation of mortgage debt, e.g. type, maturity, age, interest rate

8.4

Firm Commitment Processing Financial Statements

A. Introduction

1. Financial statements give a picture of the financial position of an individual/company at a point in time and provide historical information for measuring and evaluating the financial performance of a principal/firm and provide advance warning of financial problems.
2. Use this information to determine if the sponsors, the mortgagor and/or the principals of the mortgagor have the financial capacity to develop, build and complete the project and whether the general contractor has the ability to deliver the project based on:
 - a. Past financial condition;
 - b. Present liquidity; and
 - c. Projecting future financial capacity.
3. Complete the financial analysis with the objective of determining the amounts available for investment in the project by performing an analysis of working capital. Working capital is the difference between current assets and current liabilities. It is used to purchase assets, pay off debt and make up deficits from operations. The financial analysis also determines which non-pledged, unsecured assets can be readily hypothecated to produce the required investment.
4. See Appendix 8D for instructions on how to correctly analyze financial statements when determining the financial capability of the Mortgagor, Sponsor, General Contractor and/or Manager of an Limited Liability Company.

B. Exhibits

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

1. Individuals must submit either:
 - a. Personal Financial and Credit Statement, Form HUD-92417:
 - (1) The spouse of married sponsors or principals must also sign the form.
 - (2) If a spouse's signature cannot be obtained, the principal must prepare the form reflecting only those assets that are solely in their name and any liability, including those joint liabilities, for which they have any responsibility.
 - b. A substitute statement, which contains at a minimum the information contained on Form HUD-92417. This form must contain the following certification and criminal warning:

- (1) I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the mortgagor [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of _____'s (Name of mortgagor or owner) financial position as of _____ (date of financial statement).
- (2) Signed this ____ day of _____, 20____. Signature of authorized agent with name printed or typed under signature _____.
- (3) Warning – HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)

For married individuals, the spouse also must sign certification.

2. Business entities must submit the following separate statements and supporting documents for the last 3 years or the length of existence. If less than 3 years, an authorized officer of the organization must provide the statements and supporting documents with a signed statement that there has been no material adverse change since the date of the statements.

a. Balance Sheet which:

- (1) Provides a breakdown of current and non-current assets; a list of all other assets including the market value of each asset, the basis for calculating value (for real estate owned assets this will be shown on the schedule real estate), and any notes receivable from related entities;
- (2) Identifies restricted and non-restricted funds;
- (3) Provides a breakdown of current and non-current liabilities; identifies the current portion of long-term debt; contingent liabilities, including debts under secured or unsecured lines of credit or letters of credit, personal guaranties, obligations to limited partnerships and other obligations payable in the future, including the amount and duration of the obligation; and
- (4) Any factors that may materially affect the borrower or sponsor's financial position immediately or during the term of the mortgage.

b. Income and Expense Statement that reflects:

- (1) Income from normal operations;
- (2) Investment income;
- (3) Other income; and
- (4) Total expenses.

c. If the financial statements are audited, a Statement of Changes in Financial Position or if a fund accounting system is used, a Statement of Changes in Fund Balance, and all notes.

d. Supporting Schedules:

- (1) An Aging Schedule of Accounts Receivable that provides the name, type of account (trade, affiliate, employee, relative or other), payment terms, amount and aging information.
- (2) An Aging Schedule of Notes Receivable that provides the name, type of account, payment terms, maturity date, current portion (due within 1 year or one operating cycle of the business, whichever is less), past due amounts and non-current amount.

- (3) Schedule of Pledged Assets, if applicable. Identify the pledged asset, the amount pledged and the offsetting liability.
- (4) Schedule of Marketable Securities that provides: name, number of shares, current market values of the date of the statement, and exchange where listed.
- (5) Schedule of Accounts Payable that provides: name, type of account (trade, affiliate, employee, relative or other), payment terms, amount and aging information.
- (6) Schedule of Notes and Mortgages Payable that provides: name, type of account, payment terms, maturity date, current portion (due within 1 year or one operating cycle of the business, whichever is less), past due amounts and non-current amount.
- (7) Schedule of Legal Proceedings, if applicable.
- (8) In addition to the applicable schedules in above paragraphs, general contracting firms must submit a schedule of jobs (work) in progress that identifies the:
 - (a) Original contract price;
 - (b) Construction start date;
 - (c) Construction completion date; and
 - (d) Percentage of completion.
- (9) Schedule of Real Estate Owned (REO) that provides the following information for each physical property listed:
 - borrower/ principal's name
 - property name & address
 - Type of Property & number of units
 - property acquisition date
 - ownership role & interest
 - percent of current occupancy
 - annual net operating income
 - Present market value
 - existing mortgages, liens & dates
 - interest rate & dates
 - sum of existing amount of mortgages & liens
 - current property equity
 - annual effective gross rental & commercial income (after deducting concessions & vacancy loss)
 - annual operating expenses
 - annual debt service
 - debt service coverage ratio
 - pending judgments, legal suits/actions or bankruptcy against the property.
- (10) Schedule of Mortgage Debt is applicable only when the event of mortgage maturity is in the next five (5) years or the property is a troubled asset. Provide the following for each property listed:
 - name of creditor/ lien holder

- type of debt (e.g. FHA mortgage, conventional mortgage, bridge loan, balloon)
 - original mortgage amount or debt amount & date
 - interest rate & date (i.e. fixed, fixed bonds, variable, etc.)
 - unpaid principal balance or current debt amount & date
 - maturity date
 - monthly payment
 - balloon payment
 - collateral (Describe the security type for repayment of the mortgage or debt)
 - status current or delinquent
- e. Combined or consolidated statement(s), if applicable,
- f. Other financial data necessary to determine the financial responsibility and capacity of the sponsorship or general contractor,
- g. The certification signed and dated by an authorized official of the company, or truth and accuracy and the criminal certification. The certifications must reference the name of the business and the date of the financial statement(s).
3. Section 223(f) Project Financial Statements.

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

a. Audited Financial Statements.

A Certified Public Accountant (CPA) or Independent Public Accountant (IPA) should audit the latest year's financial statements. However, if the project owner does not maintain audited financial statements, an owner-certified financial statement for the latest year is acceptable. (See item c. below). To confirm the accuracy of the property financials, the borrower must provide three years of tax returns for the project or mortgagor entity. In addition, the borrower must provide a property financial statement that is reviewed by an independent third party CPA and includes actual copies of the insurance and property tax bills. The Multifamily Hub Director may grant a waiver of this requirement for acquisitions. The CPA review is applicable to the most recent full year financial statement and borrower certifications are acceptable for the required previous years' statements.

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

(1) The mortgagor must submit:

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

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

- c. Any owner-certified financial statement or owner-certified balance sheet and operating statement must include certification and criminal warning found in Section 8.4.B.1.b.(3) above.
- d. **Past Due Payables and Project Liabilities.** Past due accounts payable and outstanding liabilities for project operating expenses must be cleared and released, or otherwise fully satisfied, prior to or at Initial Closing. Examples of such items include deferred management fees, over-due utility bills or real estate taxes, or trade payables. These items are not to be included in the eligible debt basis in the calculation of the cost to refinance. If the transaction does not involve a Transfer of Physical Assets, and if approved by the Multifamily Hub Director, surplus cash notes may be established for payables owed to a related entity only.

C. Processing Financial Statements & Other Documents.

1. A current financial statement must be no more than 3 months old when Form HUD-92013 is submitted to the Lender for Firm Commitment review. **Determine financial stability and financial strength, unless the borrower and sponsor is a public company with investment grade credit ratings.** Exceptions:
 - a. The credit investigation or other circumstances may warrant more current financial statements.
 - (1) **Assess the adequacy of each sponsor's liquidity and its ability to provide immediate and ongoing support to the property, as well as to any other asset that is in financial difficulty. For those types of properties in financial difficulty consider that property's strength as well as liquidity sources outside the property, e.g., other sponsor(s). You must look for likely future events that may drain cash resources from the sponsor.**
 - (2) **You may include other sources of sponsor cash flow in the analysis, if the source and stability of the cash flow has been verified by reviewing historical tax returns. Other cash sources to consider are interest income (do not include interest income from notes receivable); real estate investment income; dividend income; and sponsor salaries.**
 - b. Audited financial statements prepared by an independent Certified Public Accountant or a Public Accountant may be up to a year old. The audited statements must be supplemented with updated interim financial statements **& supporting documents**, which may be management prepared, if more than six months have lapsed since the closing date of the audited statement.
2. A mortgagor entity with adequate capital **is required to provide** financial statements on the individual ownership interest(s). This mortgagor entity must be fully funded in an account in the name of the mortgagor entity.
3. A working capital determination is to be made by the Lender's underwriter for the mortgagor and the general contractor from a review of the financial statements. Working capital is the excess of current assets over current liabilities. The net working capital is to be adjusted for the effects of contingent liabilities and the financial needs of other projects in the planning stage or under construction adjusted by the percentage of completion.
4. Net worth in lieu of working capital: When fixed assets could secure loans to cover the project's financial requirements, recommend approval based on "true net worth" rather than on working capital.
 - a. Require the principal to provide a commitment letter from a lending institution that states:

- (1) The rate, amount, term and conditions, if any, of the loan that the lending institution is willing to provide.
- (2) The date by which the commitment letter must be exercised. (The date must extend at least to the anticipated date for initial endorsement).
- (3) The party that will be responsible for repayment of the loan, if the commitment is exercised.
 - (a) Repayment may not be an obligation of the mortgagor entity.
 - (b) A certification indicating that the lending institution will not make any claim against the mortgaged property, mortgage proceeds, any reserve or deposit required by HUD, or against the rents or other income from the mortgaged property for payment of the loan. This certification must contain the criminal certification.
5. Funds provided by a Parent Company or Affiliate of the Sponsor. Require a certification from the Board of Directors or authorized agent that specifies the funds the parent company/affiliate is willing to commit.
 - a. Establish the availability of funds from parent company/affiliate. Please consider whether:
 - (1) Individual corporations have any operating capital to spare.
 - (2) Laws under which they are incorporated or their banks permit:
 - (a) Withdrawals, loans or advances to owners or sponsors.
 - (b) Stock investment in affiliated corporations.
 - (c) Guarantee of debts of associated corporations.
6. Letters of intent and letters of credit cannot be used to establish financial capability. At initial endorsement, letters of credit may be substituted for cash to set up many of the escrows required at initial and final endorsement, or during construction. If a sponsor draws down cash at initial closing to satisfy escrow requirements, a letter of credit cannot be substituted to establish the same escrow requirements. When a letter of credit is permitted, it must always be:
 - a. Unconditional and irrevocable;
 - b. Issued by a banking institution; and
 - c. Valid and collectible.
7. The Lender of record may not be the issuer of any letter of credit without prior written consent of the Hub Director. If a demand under any letter of credit is not met immediately, the Lender must provide the cash equivalent to the un-drawn balance of the letter of credit.
8. Lines of Credit: Existing lines of credit may be used to establish financial capability. With the Firm Commitment application, require the principal to provide a letter from a lending institution that confirms:
 - a. The existence of the line of credit, original amount and available balance, repayment terms, and expiration date.
 - b. The line of credit expiration date cannot occur prior to project completion.
9. Sponsor's Continuing Commitments
 - a. A written statement must be submitted from principals who are sponsors indicating the parameters of their financial commitment to and contractual relationship(s) with the mortgagor:

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

syndicator or investor. This *Letter of Commitment* must specify the amount, pay-in schedule and other matters so that HUD and the Lender can ensure sufficient equity in a manner that meets HUD's other requirements. The Lender underwriting the loan will also make the determination to require additional documentation (e.g. financial statements, etc.). See Chapter 14 for further guidance on underwriting an application with tax credits.

Recognizing that the borrower or sponsor's financial capacity may be weaker in affordable housing transactions, you must focus on the LIHTC syndicator's financial strength and experience, if they have ownership interest in the mortgagor entity. You must evaluate the syndicator's reputation and financial strength to determine whether its experience and capacity is sufficient with respect to the property, as addressed in Section 8.3.D and 8.4.J above. Evaluating the syndicator is important because investors expect syndicators to support transactions that have cash flow problems or to replace nonperforming general partners. In addition, the syndicators must typically assess the appropriate amounts of reserves at both the property and fund levels and must perform certain asset management functions.

8.5

Term of Mortgage and Commencement of Amortization

- A. For Sections 220, 221(d)(3), 221(d)(4), and 231 projects:
1. The term of the mortgage is the lesser of 75% of the estimated remaining economic life of the physical improvements or 40 years from the date of the first payment to principal.
 - a. Express the mortgage term in whole or partial years.
 - C.** Express fraction of a year as 26 years, 3 months.
 2. Amortization starts:
 - a. For Insurance of Advances projects, no later than 4 months after the date of construction completion.
 - b. For Insurance Upon Completion project, the first day of the second month following the date of final endorsement.
- B. For Section 207 pursuant to 223(f) projects:
1. The term of the mortgage shall not be less than 10 years, nor shall it exceed the lesser of 35 years or 75 percent of the estimated remaining economic life of the physical improvements.
 - a. The mortgage term shall be the eligible number of whole or partial years between 10 and 35.
 - b. Express fraction of a year as 26 years, 3 months.
 2. Amortization starts on the first day of the second month following the date of the initial/final endorsement of the mortgage for insurance.

8.6

Additional Firm Commitment Processing Exhibits

- A. For Sections 220, 221(d)(3), 221(d)(4), 231, and 207 pursuant to 223(f) projects:

1. HUD-92013, Application for Multifamily Housing Project
2. HUD-92264, Rental Housing Project Income Analysis and Appraisal
3. HUD-92264-A, Supplement to Project Analysis

8.7

Sections 220, 221(d) and 231 Firm Commitment Processing - Determining Mortgage Amounts, Cash Requirements, and Related Items

A. Firm Commitment Processing.

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

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>	
221(d)(3), 231	Nonprofit	90	[Projects w/ 90% or greater rental assistance]
221(d)(4), 220, 231	All Mortgagors	90	[Projects w/ 90% or greater rental assistance]
221(d)(4), 220, 231	All Mortgagors	87	[Affordable]
221(d)(4), 2201, 231	All Mortgagors	83.3	[Market Rate]

- c. An amount attributable to dwelling use, excluding exterior land improvements, not to exceed:
 - (1) For walk-up structures:
 - (a) Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3), the per family unit limits in Appendix 8B.
 - (b) Projects involving eligible mortgagors to be insured under Section 221(d)(4), the per family unit limits in Appendix 8B.
 - (c)** Projects involving eligible mortgagors to be insured under Section 220, the per family unit limits in Appendix 8B.
 - (d)** Projects involving eligible mortgagors to be insured under Section 231, the per family unit limits in Appendix 8B
 - (2) For elevator type structures:
 - (a) Projects involving eligible nonprofit mortgagors to be insured under Section 221(d)(3), the per family unit limits in Appendix 8B.
 - (b) Projects involving eligible mortgagors to be insured under Section 221(d)(4), the per family unit limits in Appendix 8B.

- (c) Projects involving eligible mortgagors to be insured under Section 220 the per family unit limits in Appendix 8B.
- (d) Projects involving eligible mortgagors to be insured under Section 231, the per family unit limits in Appendix 8B
- (3) Per family unit limits may be increased by:
- The approved High Cost Percentage (HCP) for the jurisdiction in which the project will be located.
 - A percentage above the approved HCP up to 140 percent maximum, or 170 percent in high-cost areas, which results in a maximum of 270 percent of the base per family unit limits, or 315 percent in high-cost areas. Hub Directors in the project jurisdiction may exercise their waiver authority on a case-by-case basis to increase the HCP.
 - The limits for walk-up and elevator structures may be increased by up to 20 percent, if necessary, for purchase and installation of a qualified solar energy system. This is in addition to any increase in a high cost area.
 - If the Commissioner finds good cause in Alaska, Guam, Hawaii, or the Virgin Islands, the maximum high cost percentage may be increased by up to one-half.
- (4) The amount in (3) above may be increased by the percentage of the cost not attributable to dwelling use, from Section M Line 15 of the Form HUD-92264 and the “Warranted Price of Land.” This corresponds to Section G Line 73a of Form HUD-92264, Multifamily Summary Appraisal Report, for new construction deals. For substantial rehabilitation deals, the “Estimated Value of the Land without Improvements” from Section H must be used.

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
221(d)(3), 231	Nonprofit	90 [Projects w/ 90% or greater rental assistance]
221(d)(4), 220, 231	All Mortgagors	90 [Projects with 90% or greater rental assistance]
221(d)(4), 220, 231	All Mortgagors	87 [Affordable]
221(d)(4), 220, 231	All Mortgagors	83.3 [Market Rate]

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

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
221(d)(3), 231	Nonprofit	90 [Projects w/90% or greater rental assistance]
221(d)(4), 220, 231	All Mortgagors	90 [Projects w/ 90% or greater rental assistance]
221(d)(4), 220, 231	All Mortgagors	87 [Affordable]

221(d)(4), 220, 231 All Mortgagors 83.3 [Market Rate]

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

- (1)** That portion of the maximum mortgage supported by the tax abatement must be amortized over the life of the abatement.
- (2) The Tax Abatement must run with the real estate and not with the type of sponsorship.

NOTE: Projects that have 90 percent or greater rental assistance the DSCR is 1.11 (90% of net income), or an affordable project the DSCR is 1.15 (87% of net income), or a market rate project the DSCR is 1.20 (83.3% of net income).

2. Amount of Loan – Rehabilitation **Section 220 and 221(d)**. (This includes only projects involving substantial rehabilitation or reconstruction.) The insurable amount is the lowest of:
 - a. Amounts in paragraph 8.7.A.1, except b.
 - b. The result of the Lender's cost estimate of rehabilitation and fair market value of the land and existing improvements before rehabilitation, multiplied by the applicable percentage.

<u>Section</u>	<u>Mortgagor</u>	<u>Percent</u>
221(d)(3)	Nonprofits	90 [Projects w/90% or greater rental assistance]
220, 221(d)(4)	All Mortgagors	90 [Projects w/90% or greater rental assistance]
220, 221(d)(4)	All Mortgagors	87 [Affordable]
220, 221(d)(4)	All Mortgagors	83.3 [Market Rate]

3. Amount of Loan – Rehabilitation **Section 231**. (This includes only projects involving substantial rehabilitation or reconstruction.) The amount as set forth under new construction except the limitation is the estimate of value rather than replacement cost. The insurable amount is the lowest of:

a. Amounts in Section 8.7.A.1, except b.

b. Property owned - One hundred percent of the estimated cost of rehabilitation plus the lesser of:

- (1)** Principal amount of existing indebtedness against the property, and closing charges, or
- (2)** Ninety percent (100 percent for nonprofit mortgagors) of the Lender's estimated appraised value of the property before rehabilitation and closing charges less:

- (a) Value of leased fee, if leasehold, and/or
 - (b) Principal amount of special assessment.
- C.** Property to be acquired – Ninety percent (100 percent for nonprofit mortgagors) of the Lender’s estimated current cost of rehabilitation/reconstruction plus the lesser of:
- (1)** Ninety percent (100 percent for nonprofit mortgagors) of the actual purchase price of the property and closing charges, or
 - (2)** For-profit mortgagors: 90 percent of the Lender’s estimated appraised value of the property before rehabilitation and closing charges and/or principal amount of special assessment.
4. Complete Criteria 11 for all Sections of the Act when secondary financing applies.
- Amount Based on Deduction of Grant(s), Loan(s), Tax Credit(s) and Gift(s) for Mortgageable Items.
- (1) 100% Replacement Cost* less the sum of all Grants/loans/gifts and Tax Credits.
- *Project Replacement Cost applies to Section 221(d) and other Sections of the Act mortgages limited by replacement cost.

8.8

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

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

1. Amount of loan in a purchase transaction.

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

- a. Application amount; or
- b. An amount not to exceed either 87 percent for projects with 90% or greater rental assistance; **or** 85 percent if affordable, **or** 83.3 percent if a market rate project multiplied by the Lender's estimate of value as repaired. These loan-to-values apply to both for-profit and nonprofit mortgagors.
- c. The maximum per family unit limitation for new construction under Section 207 may be increased by the percentage of the cost not attributable to dwelling use, from Section M Line 15 of the Form HUD-92264 and the “Warranted Price of Land.” This corresponds to Section G Line 73a of Form HUD-92264, Multifamily Summary Appraisal Report, for new construction deals. For substantial rehabilitation deals, the “Estimated Value of the Land without Improvements” from Section H must be used.

NOTE: Per family unit limits may be increased. See Section 8.7.A.1.c. (3) and Appendix 8B.

- d. Debt service that does not exceed Section A.1.b above for for-profit and nonprofit mortgagors of projects' estimated net income. The mortgage may exceed this limit by capitalizing the savings from any tax abatement. In such cases, the net earnings estimate will not reflect that temporary tax abatement.
- (1) Projects that have 90 percent or greater rental assistance the DSCR is 1.15 (87% of net income), or an affordable project the DSCR is 1.176 (85% of net income), or a market rate project the DSCR is 1.20 (83.3% of net income).
 - (2) That portion of the maximum mortgage supported by the tax abatement must be amortized over the life of the abatement.
 - (3) Tax Abatement must run with the real estate and not with the type of sponsorship.
- e. Refer to the percentages in Section 8.8.A.1.b above for for-profit and nonprofit mortgagors of the cost of acquisition, which is defined as the sum of the items:
- (1) Purchase price shown in the purchase agreement and determined allowable by the Lender.
 - (2) The Lender's estimate of repair cost, if any, provided such costs are paid by the mortgagor and are not included in the purchase price.
 - (3) The sum of reasonable financing charges, legal, organizational, and title and recording expenses paid by the mortgagor.
 - (4) Eligible discounts paid by the mortgagor.
NOTE: Any fees, discounts or other amounts paid by the seller for or on behalf of the purchaser must be reflected as a reduction to the acquisition cost.
 - (5) The initial deposit to the Reserve Fund for Replacement provided such deposit will be funded by the purchaser.
 - (6) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable, and other fees as may be determined eligible by the Lender including the cost of Lender third party reports.
 - (7) Less the amount of any: Reserve escrow for replacement that will be purchased as an asset of the project.
- f. Complete Criteria 11 for all Sections of the Act when secondary financing applies.
Amount based on Deduction of Grant(s), Loan(s), Tax Credit(s) and Gift(s) for Mortgageable Items. (Criteria 11)
- (1) 100% Project Costs* less the sum of all Grants/loans/gifts, Tax Credits for mortgageable items.
*Project Cost applies to Criteria 7 Line g and 10 Line g under 223(f) and applications pursuant to 223(f).
2. Amount of Loan in a Refinancing Transaction:
The subject loan will be the lesser of:
- a. Amounts in Section 8.8.A.1., except e.
 - b. An amount that equals the greater of the following:
 - (1) 80 percent of the Lender's estimate of the value of the project, or
 - (2) The cost to refinance the project, which is defined as the sum of:

- (a) The amount needed to pay off the existing indebtedness as determined eligible by the Lender.
 - (b) The initial deposit to the Reserve Fund for Replacements.
 - (c) The sum of reasonable financing charges, legal and organizational, and title and recording expenses paid by the mortgagor.
 - (d) The Lender's estimate of repair cost, if any.
 - (e) Eligible discounts paid by the mortgagor.
 - (f) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable, and other fees as may be determined eligible by the Lender including the cost of Lender third party reports.
 - (g) Less the amount of any: Reserve escrow for replacement and/or major movable equipment that will be purchased as an asset of the project.
- c. Complete Criteria 11 for all Sections of the Act when secondary financing applies.
Amount based on Deduction of Grant(s), Loan(s), Tax Credit(s) and Gift(s) for Mortgageable Items.
- (2) 100% Project Costs* less the sum of all grants, loans, gifts, tax credits, for mortgageable items.
- *Project Cost applies to Criteria 7 line g and Criteria 10 line g under 223(f) and applications pursuant to 223(f).

d. **Release of Cash / Equity from Loan Proceeds.**

The loan to value ratio (in criterion 10 of Form HUD-92264-A) for cash out refinances remains unchanged at 80%. Fifty percent (50%) of any cash out proceeds after funding any transaction costs, including the assurance of completion requirements, must be held in escrow by the Mortgagee until the required non-critical repairs are completed and HUD approves the release. **Non-critical repairs are defined as Endanger the safety and well-being of tenants, visitors and passersby; adversely affect ingress or egress; or prevent the project from reaching sustaining occupancy.**

B. Treat any property acquired:

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

C. Identity of Interest Purchase Transaction.

Refer to Chapter 13, Section 13.15.

D. Determining Existing Indebtedness in a Refinancing Transaction.

Existing indebtedness in a refinancing transaction is defined as:

1. Outstanding mortgage(s) incurred in connection with the construction of the project or with capital improvements made to the property as confirmed by the current mortgagee. Use the pay-off letter which appears in Appendix 8C of this Guide.

2. Other recorded indebtedness such as mechanic's liens and tax liens provided they did not result from personal obligations of the mortgagor.
3. Unrecorded debt directly connected with the project supported by documentation from the mortgagor. If the indebtedness is not recorded, the mortgagor must provide the Lender with documentation, which unquestionably identifies the indebtedness with the project. Examples are:
 - a. Delinquent interest
 - b. Prepayment penalties on the mortgage
 - c. Indebtedness incurred in making significant betterments to the property

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

4. Mezzanine Debt. Mezzanine debt is only considered in the eligible basis where there is no identity of interest between the principals and the affiliates of the Mezzanine Lender, or there is no identity of interest recognized for capital improvements. Mezzanine debt can be included in the eligible debt basis in a refinance if the loan documents associated with the mezzanine clearly identify the debt as directly connected with the property.

5. Do not recognize indebtedness:
 - a. Recently placed against the project to increase the mortgage or circumvent program intent. **NOTE:** HUD defines "recent indebtedness" as any debt incurred up to one year before application for mortgage insurance is made. However any/all recent debt not incurred as part of the construction of the project or incurred for capital improvements made to the property is ineligible. Sufficient documentation must be provided in support of said debt being incurred on/for the project
 - b. Created by wrap mortgages
 - (1) Unless the mortgagor and Lender give a detailed explanation of the purpose of the wrap and a documented accounting of disbursement of the loan proceeds.
 - (2) You may recognize loan proceeds used for capital improvements or project operations.

E. Reserve for Replacements.

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

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

2. Refinancing Transaction. The mortgagor must submit a list of escrows currently on deposit for the project:
 - a. The escrows must remain with the project.
 - b. Apply funds currently on deposit in a Reserve Fund for Replacements as a reduction of:
 - (1) The cost of refinancing under criterion 10 on Form HUD 92264-A.
 - (2) The initial deposit to the Reserve Funds for Replacement. Use the excess to cut the costs of discounts, miscellaneous fees and charges, etc., included in the determination of the maximum insurable mortgage.

- F. Discounts and/or Costs of Issuance associated with bond financing may be eligible for inclusion in the computation of Criteria 7 and 10.
 1. Review documentation regarding permanent financing. Documentation must state the amount of the discounts, financing fees, and/or costs of issuance to be charged and with whom they will be paid.
 2. Permanent Placement Fee. This fee must include all permanent placement expenses except discounts. Where GNMA Mortgage-Backed Securities (MBS) are involved and the mortgagee charges:
 - a. The maximum permanent placement fee, it may not assess an additional charge for either the MBS application fee and/or the securities custodial fee.
 - b. Less than the maximum permanent placement fee, it may assess an additional charge for either the MBS application fee and/or the securities custodial fee provided the total fees and charges do not exceed the dollar value of the maximum permanent placement fee.
 3. Determine if the discounts, financing fees and costs of issuance are reasonable and in line with prevailing market conditions and mortgage credit data.

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

 - a. Bond fees included in the mortgage transaction:
 - (1) Where a project is to be financed through the sale of either taxable or tax-exempt bonds, the maximum financing fees allowable in the mortgage computation and recognizable for cost certification purposes is 5.5 percent of the mortgage amount. Any cost beyond the 5.5 percent must be paid from sources outside the mortgage.
 - (2) The maximum financing fee the mortgagee may retain for its own account is 3.5 percent. This 3.5 percent covers the costs of origination, processing, underwriting, closing and delivery (including the mortgagee's legal fees), escrow monitoring, permanent placement, etc. The remaining 2 percent (or such greater percentage as may result from the Lender reducing its maximum retainable 3.5 percent fee) may be used to offset the cost of bond fees.
 - b. Discounts. In a refinancing or purchase transaction, discounts will be recognized only for those actual costs charged by the placement Lender, which are determined to be eligible. Discounts included in the computation of Criteria 7 and 10 must be reasonable based on current market conditions.
 4. Do not recognize:
 - a. Financing fees and discounts beyond the 3.5 percent included in the mortgage where an identity of interest exists between:

- (1) The sponsor/mortgagor and the new permanent Lender.
 - (2) The present permanent Lender or the interim Lender and the new permanent Lender, in a refinancing transaction.
- b. GNMA application fee and securities custodial fee, where the GNMA Mortgage-Backed Securities Program will be used for permanent financing, since they are paid from the permanent placement fee.
 - c. Charges for warehousing a mortgage for future delivery.

8.9**Secondary Financing**

The terms and conditions of secondary financing are:

- A. The secondary financing is represented by a promissory note, Form FHA-2223. This note shall not be altered in any manner.
- B. The amount of the secondary financing is based on the source of funding.
 1. For all Sections of the Act, when the loan is from Government Sources:
 - a. Secondary financing, grants and tax credits from a Federal, State, or local government agency or instrumentality, may be used to cover up to 100% of the applicable Section of the Act equity requirement.
 - b.** Secondary financing, grants, and tax credits from a Federal, State or local government agency or instrumentality, may also be used to finance non-mortgageable costs, when added to the HUD mortgage and required equity contribution, may exceed 100% of the project's Fair Market Value (FMV) or Replacement Cost.
 - C.** Subordinated liens against the property that result from secondary loans from a Federal, State or local governmental agency or instrumentality to cover non-mortgageable costs and/or equity, in combination with HUD's primary lien, may exceed 100% of the property's FMV or Replacement Cost.
 - d.** Non-mortgageable costs or non-HUD replacement cost items, covered by secondary loans, grants and tax credits must be certified by the source provider to be required to complete the project and that the related costs are reasonable. Documentation to this effect must be included with the application submission.
 2. When the loan is from a Private Source (Section 223(f) and Sections of the Act pursuant to 223(f)):
 - a. Secondary financing in the form of a promissory note is permitted to cover a portion of the equity requirement under Section 223(f). The aggregate amount of the FHA insured first loan and the private second loan cannot exceed 92.5% of FMV. Therefore, the amount of a private loan may range from 7.5% of FMV (the difference between 85% and 92.5% of FMV) to a larger percentage if mortgage criteria lower than 85% of FMV controls.
Secondary financing from private sources are not permitted under other Sections of the Act.
 - b. When private secondary financing is combined with Federal, State or local government agency secondary financing, like in (a) above, the aggregate amount of HUD insured first

loan and the private second loan cannot exceed 92.5% of FMV. However the governmental loan, in aggregate with the HUD first and private second, may exceed the property's FMV. The addition of the governmental loan may result in total liens that exceed the property's FMV.

- c. Private secondary financing may be used to cover non-mortgageable costs in combination with equity or solely for one purpose or the other. Whatever option is decided upon, as stated in (a) above, the aggregate of the HUD first and private second cannot exceed 92.5% of FMV.
- d. Non-mortgageable costs or non-HUD replacement cost items, covered by secondary financing from private sources must be certified to be reasonable and required to complete the project by the provider of sources in documentation included with the application submission.
- e. Mezzanine Financing. Any mezzanine debt that remains after a previous closing is subject to the secondary financing guidance here in Section 8.9.B.2 above. Repayment of financing is only made from surplus cash. Any transfer of ownership interest to the mezzanine lender in the event of a default must have prior written approval by the HUD through the transfer of physical process.

- C. Repayment of the secondary financing including interest is geared solely to the availability of surplus cash. Include the following language in the Note:

"So long as the Secretary of Housing and Urban Development or his/her successors or assigns, are the insurers or holders of the first mortgage on (insert project name and FHA Project No.), payments due under this Note shall be payable only from surplus cash (or residual receipts) of said project, as the term surplus cash (or residual receipts) is defined in the Regulatory Agreement dated (insert date) between HUD and (insert name of mortgagor). The restriction on payment imposed by this paragraph shall not excuse any default caused by the failure of the maker to pay the indebtedness evidenced by this Note."

- D. The mortgagor may secure a promissory note with an inferior lien against the property under the following conditions:
 - 1. The mortgagee of the HUD-insured first mortgage must consent to the placing of the inferior lien and agree that its existence doesn't constitute a basis for default on the first mortgage.
 - 2. There must be a simultaneous closing and same day recordation of the secondary financing documents and the insured first mortgage loan documents.
 - 3. The terms of the second mortgage are:
 - a. Approved by the Area Counsel;
 - b. Consistent with the terms of the promissory note, the first mortgage, the Regulatory Agreement and all HUD regulations and requirements.
 - c. The second mortgage shall not contain a cross default provision or any right of foreclosure before the termination of the HUD mortgage insurance.
 - d. The term of the second mortgage may be extended, if:
 - (1) The note matures, there are no surplus cash funds or residual receipts available for repayment and the first mortgage has not been repaid in full.

- (2) HUD grants a deferment of amortization or forbearance that result in an extended maturity of the insured mortgage.
 - e. The second mortgage is assumable when a sale or transfer of physical assets occurs and the mortgage insurance remains in place.
 - (1) The holder of the second mortgage cannot require that more than 70 percent of the net proceeds of the sale or transfer be applied to the reduction of the loan.
 - (2) For these instructions, net proceeds are the funds available to the original mortgagor after:
 - (a) Correcting any monetary or covenant default on the first mortgage.
 - (b) Making:
 - (i) Required contributions to any reserve funds.
 - (ii) Needed improvements to the property as evidenced by HUD's annual inspection reports.
 - f. The second mortgage automatically terminates if HUD acquires title to the project by a deed in lieu of foreclosure.
 - g. Only 50 percent of surplus cash or residual receipts can be pledged to the repayment of the secondary loan(s). However, at the owner's option additional payments may be made from time to time.
- E. Identify all secondary grant/loan funds in Section III "Source of Funds to Meet Cash Requirements" Form HUD-92264-A.

8.10**Firm Commitment Processing with Grants/Loans**

A. In General

These instructions apply to:

1. Grants and loans to the mortgagor entity from a Federal, State or local government agency or instrumentality.
2. Loans to principals of the mortgagor entity from a Federal, State or local government agency or instrumentality.
3. Grants and loans to the mortgagor entity or its principals from national, regional and local community service organizations (nongovernmental source), e.g., Ford Foundation, Rockefeller Foundation, etc.
4. Low Income Housing Tax Credit (LIHTC) and Historic Tax Credit syndication proceeds. See Chapter 14 for streamline processing procedures involving LIHTC's.

B. Application for Mortgage Insurance.

1. At the commitment processing stage, the applicant:
 - a. Identifies the use of grant/loan funds on Form HUD-92013, Application for Project Mortgage Insurance.
 - b. Submits either:

- (1) A commitment letter signed by an authorized agent of the government agency or instrumentality or the non-government source identifying:
 - (a) Amount of grant/loan funds.
 - (b) Intended use of the grant/loan funds.
 - (c) Any conditions for the loan and reasons, if any, the letter of intent could be withdrawn.
 2. For those cases involving a grant/loan from a government/agency or instrumentality, an application showing the information above.
 3. Any type of grant(s) or loan(s) not disclosed (as outlined above) by the mortgagor will likely result in a rejected application or an issued firm commitment made null and void.

Non-disclosure is considered a significant deviation from the original financial intent of the application at these times of firm processing:

 - a. The time of application submission.
 - b. Any stage through firm commitment.
 - c. After issuance of the firm commitment, but before the initial endorsement occurs.
- C. The Rental Housing Project Income Analysis (HUD-92264) and the Supplement to Project Mortgage Analysis (HUD-92264-A) are to be completed in accordance with instructions for each specific program.
- D. Grants/Loans from government agency or instrumentality.
1. Initial Endorsement
 - a. Before scheduling the closing, the Field Counsel must review the grant/loan documents to assure the legal sufficiency of the documents.
 - b. The Lender must consent in writing to the existence of the second mortgage and agree that its existence does not constitute a basis for default on the first mortgage.
 - c. The mortgagor may use instead of that portion of the front money escrow provided by the grant/loan, either:
 - (1) An unconditional irrevocable letter of credit issued by a banking institution, or
 - (2) An agreement entered into by HUD, the government agency or instrumentality, the Lender and the mortgagor, which provides the following:
 - (a) HUD has:
 - (i) The right to approve construction advances after considering any reported noncompliance by the agency or instrumentality if the project is proceeding in compliance with approved plans and specifications.
 - (ii) Sole authority to resolve differences in the inspection process and disbursement of grant/loan proceeds.
 - (b) The Lender will concurrently furnish HUD and the agency or instrumentality with copies of the approved interim advances [Form HUD-92448, Contractor's Requisition, Form HUD-92403, Application for Insurance of Advances of Mortgage Proceeds, and supporting documentation].
 - (c) The agency or instrumentality must process the advance promptly and without adjustment.

- (i) Send the agency or instrumentality a copy of the approved requisition for its records.
- (ii) The agency must notify HUD and the Lender of a need to make an adjustment the following month.
- (d) The agency or instrumentality assumes the risk for any grant/loan funds disbursed in excess of the amount approved by HUD or the Lender and agrees to replenish the excess funds within 10 working days of notification by HUD or the Lender.
- (e) If a default occurs before completion of construction, the agency or instrumentality must disburse the remaining funds so long as the request for funds remains in the same ratio as previously authorized.
- (f) The agency or instrumentality's attorney must render an opinion that the agreement and grant/loan commitment is legally binding on present and all future administrations.
- (g) The mortgagor must post either a cash escrow or an unconditional, irrevocable letter or credit equal to no less than 10 percent of the grant/loan proceeds.
 - (i) The Lender must draw upon the escrow if the government agency or instrumentality fails to advance the grant/loan proceeds in a timely manner.
 - (ii) The mortgagor must reinstate any portion of the escrow drawn during the term of the construction loan, within 10 days of the draft for payment.
 - (iii) HUD must establish control of the escrow in a separate agreement.
 - (iv) The escrow may be released at final endorsement.
- d. Grant/loan proceeds must be advanced either:
 - (1) Before mortgage proceeds, or
 - (2) Concomitantly on a pro rata basis with the disbursement of mortgage proceeds.

NOTE: If the grant/loan proceeds are not available at initial endorsement, HUD may either:

 - (a) Proceed to initial endorsement, but not disburse any mortgage proceeds until the grant/loan is in place and the funds are available, or
 - (b) Have the mortgagor/sponsor fund an escrow equal to the grant/loan. Advances from this escrow must follow outstanding instructions for the disbursement of the grant/loan.
 - (3) Release of grant/loan proceeds cannot be geared to the completion of specific improvements.
- e.** See Chapter 14 for front money requirements and disbursement of mortgage proceeds on Low Income Housing Tax Credit projects.

E. Grants/Loans from non-government source

1. Commitment Processing.

- a. Financial statements must be submitted which evidence that the providing source has the financial capacity to meet its commitment.
- b. The latest 3 years published audited financial statements, if available, must be submitted.

- c. If audited financial statements are not available, unaudited statements, which meet the requirements of Section 8.4.C must be provided.
2. Initial Endorsement.
 - a. Before scheduling the closing, HUD reviews the grant/loan documents to assure the legal sufficiency of the documents.
 - b. The grant/loan funds must be escrowed with the Lender before or at initial endorsement.
 - c. The grant/loan funds must be disbursed before mortgage proceeds.
 - d. Release of grant/loan proceeds cannot be geared to the completion of specific improvements.
 3. All work performed with the grant/loan proceeds:
 - a. Must be cost certified.
 - b. Must conform to Davis-Bacon requirements including submission of payrolls, certifications, etc.

8.11

Subsidy Layering/Tax Credits

A. General

Under the Housing and Economic Recovery Act of 2008, multifamily mortgages insured under any provision of Title II of the National Housing Act (12 U.S.C. 1707 et seq.) are exempt from a subsidy layering review.

Also, where equity is provided through any low income housing tax credit pursuant to Section 42 of the Internal Revenue Code of 1986 (26 U.S.C. 42), and where the Secretary has determined at the time of issuance of the firm commitment for insurance that the ratio of loan proceeds to the actual cost of the project is less than 80 percent, these projects are exempt from providing a cost certification.

8.12

Evaluating Nonprofit Sponsors and Mortgagors

A. General

The best interest of the HUD is to do business with nonprofit mortgagor/sponsors (whether national, regional, or local) that have experience and financial strength appropriate for the proposed property. This section sets forth the criteria for making this evaluation. The nonprofit mortgagor/sponsor being evaluated may not be equally strong with respect to all criteria. In transactions where the mortgagor/sponsor's ownership structure contains multiple nonprofit entities performing differing functions, you must evaluate each nonprofit on its capacity to perform its particular function, e.g. ownership, property management, acquisition, development, or asset management. This includes the need for prior acceptable history of successful development, ownership and management of assets similar in size and complexity as the proposed project. Therefore, only the criteria for the areas in which the nonprofit entity has direct responsibility or authority need to be applied during the evaluation process. Decide general eligibility of

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

- 1.** A description of who is paying pre-development cost.
- 2.** Details of proposed rent/income restrictions.
- 3.** Copy of Form HUD-92013, Application for Mortgage Insurance.
- 4.** Forms HUD 3434, Certificate of Relationships and Nonprofit Motives and HUD-3435, Certificate of Contractual Relationships.
- 5.** Developers Agreement or any other document which shows the relationship and work responsibilities of all parties associated with the transaction.
- 6.** Housing Consultant's contract, if applicable.
- 7.** Evidence of site control.
8. Memorandum of Findings & Recommendations.
 - a. It must include a description of the relationship between the nonprofit and profit motivated entities involved in the transaction.
 - b. The determination of eligibility or ineligibility of the nonprofit sponsor/borrower must be signed off personally by the Hub/Program Center Director.
9. Explain in writing any nonperforming assets in nonprofit mortgagor/sponsor portfolio.

B. Required Exhibits from Nonprofit Sponsor.

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

1. Detailed explanation of motivation for sponsoring the project including a history of the organization's involvement in multifamily housing.
2. Copy of sponsor/mortgagor's charter and bylaws or constitution as currently amended.
3. Copy of a current effecting ruling from the Internal Revenue Service on sponsor/mortgagor's tax-exempt status as a 501(c)(3).
 - a. Copy of any ruling denying tax exemption
 - b. If a ruling is pending, explain the application's legal and factual basis and current status.
4. List of officers, directors or trustees of the sponsoring group/mortgagor including addresses and titles of positions and their social security numbers.
5. Resumes on all principals and staff who will actively take part in the development of the proposed project. The property manager must have a minimum of three years of experience in managing at least five properties comparable to the proposed property in scale, complexity and regulatory compliance requirements. An asset manager must demonstrate adequate asset management experience with properties comparable to the subject property.
6. Current financial statement (balance sheet, profit and loss statement, and supporting schedules) as well as statements for the past 3 years. If available, audited statements should be submitted.

- a. If the sponsoring group/mortgagor has existed less than 3 years, the financial statements must be submitted from the date the group was formed.
 - b. Statements must identify restricted and unrestricted assets (liquidity) along with the related liabilities **and no material, unmitigated contingent liabilities.**
 - c. An officer of the sponsoring group must sign financial statements.
 - d. All statements must contain the certification of truth and accuracy and criminal certification identified in Section 8.4.B.1.b. This certification must reference the name of the sponsor and the date of the financial statements.
7. Signed written resolution of its directors or trustees, acknowledging the responsibilities and obligations of sponsorship and continuing ownership, and that this position reflects the will of the membership. **The nonprofit mortgagor/sponsor must not have any unresolved internal control or compliance findings; unresolved issues of integrity or conflict of interest.**
 8. Form HUD-92013-SUPP listing current bank and trade references for the sponsor/mortgagor, if formed, and their officers (President, Vice President, Secretary and Treasurer).
 9. The information contained in Section 8.3.G.1.a, b, and c if the sponsor/mortgagor or any officer has a prior Federal default or claim.
 10. Detailed statement of arrangements made or proposed for the following (listing principals involved, their relationship with the sponsor/mortgagor, the terms of the arrangements and the circumstances surrounding each):
 - a. Land on which the project will be built.
 - b. Project construction, including selection of general contractor, subcontractors and architect.
 - c. Legal and consulting services.
 - d. Project financing, including any discounts.

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

11. **The mortgagor/sponsor must have a proven record of raising sufficient funds to meet its operating needs. It is desirable that the mortgagor/sponsor has access to diverse and stable funding sources. You must identify whether the mortgagor/sponsor's primary funding sources are from fees on development projects or from competitive sources such as public funding, grants, gifts, or donations that may be subject to budget constraints.**

C. Mortgage Credit Review Stage.

1. Review Form HUD-3433 to see if the nonprofit sponsor/mortgagor is qualified to start, complete and operate a project under one of HUD's insured loan programs. Determine that all of the following criteria are satisfied:
 - a. Sponsor/mortgagor is acting on its own behalf and is not, either knowingly or unwittingly, under the influence, control or direction of any outside party seeking to derive a profit or gain from the proposed project—such as a landowner, real estate broker, contractor, architect, attorney or consultant.
 - b. Sponsor/mortgagor has continuity and a serious long-range desire to supply housing for the intended client group.
 - c. Sponsor/mortgagor has:

- (1) Strong roots in the neighborhood and community
 - (2) Good reputation for reliability, service and commitment to the people for whom the housing is to be built.
 - d. Sponsor/mortgagor fully understands the responsibilities and obligations in developing a housing project and continuing its successful operation. This is evidenced partly by:
 - (1) General knowledge of the factors that contribute to project success or failure.
 - (2) Familiarity with the housing programs.
 - (3) Clear, specific objectives.
 - e. Sponsor/mortgagor acknowledges, by majority resolution of its directors or trustees, the responsibilities and obligations of sponsorship to develop and manage the project. This position reflects the will of its membership. The nonprofit mortgagor/sponsor must not have any unresolved internal control or compliance findings; unresolved issues of integrity or conflict of interest.
 - f. Sponsor/mortgagor and its principals are reliable based on:
 - (1) Reputation and Past Performance.
 - (2) Success and extent of previous experience, including the type of service furnished (financial, volunteer work, management, etc.), in providing housing or related social services.
 - g. Sponsor/mortgagor is providing or has arranged for the professional and management skills essential to the successful start, development, completion, and operation of the proposed project.
2. Credit investigation.
- a. Order data and/or commercial credit reports on the sponsor/mortgagor, if formed and residential credit reports for the officers of the mortgagor entity and make inquiries of bank and trade references identified on Form HUD-92013 Supp to determine basic acceptability of credit reputation and previous experience. A credit review of members of nonprofit board of directors is not required unless they are also an officer with decision making role over the property.
 - b. Check for the existence of any delinquent Federal debt.
 - c. Check with other HUD Offices in whose jurisdiction the nonprofit has done or now does business.
 - d. Check that the mortgagor/sponsor has no unresolved issues related to payment history and must provide credit references.
3. Analysis of financial data.
- a. Determine:
 - (1) Amount of cash and liquid assets available for investment in the project.
 - (2) Whether the nonprofit entity has used prudent judgment in its past and present business affairs.
 - (3) Overall financial condition of the sponsoring group, particularly whether the financial statements indicate that income will be sufficient to meet the expenses incurred by the group.

- b. Financial statements of many large nonprofit organizations show various fund accounts, such as general and building fund, etc.
 - (1) Look out for interfund receivables and payables that cancel each other.
 - (2) Do not consider restricted-use funds in the analysis.
 - (3) Review the Public Records section of the credit report to eliminate assets, which were used as collateral in secured borrowing.
 - c. Project size should be in keeping with the abilities of the sponsoring organization.
- D. Submitting forms HUD-3434, Certificate of Relationships and Nonprofit Motives, and HUD-3435, Certification of Contractual Relationship.
- 1. At the Firm Application stage and prior to initial endorsement (beginning of construction in the case of insurance upon completion), the sponsor and mortgagor must certify on Form HUD-3434, their relationships with parties or firms furnishing land and services.
 - 2. Such parties or firms certify on Form HUD-3435 their relationship with the sponsor and mortgagor.
 - 3. If there is a change in the certified relationship, the sponsor, mortgagor and other parties must furnish additional certifications with respect to each change.
 - 4. All relationships are subject to HUD approval. HUD reserves the right to refuse endorsement of the note for insurance and to cancel the commitment if such relationships aren't approvable.
- E. Nonprofit Sponsor and a Profit-Motivated Mortgagor Entity.
- A nonprofit sponsor may request to establish a profit-motivated mortgagor entity for the purpose of obtaining BSPRA and distributions from surplus cash. Such a request may be approved provided:
- 1. The HUD Field Counsel determines that there is no legal impediment that would prohibit approval of the request.
 - 2. The nonprofit agrees to be regulated by the terms and conditions of the regulatory agreement (Form HUD-92466, Regulatory Agreement Multifamily Housing Projects) applicable to a profit-motivated entity.
 - 3. The nonprofit is subject to the mortgage limitations applicable to a profit-motivated entity.
 - 4. A working capital deposit is required.
 - 5. A nonprofit developer's fee is not included in the mortgage.
 - 6. If the nonprofit provides evidence that it has obtained exemption from real estate taxes, the tax exemption must run with the real estate and not with the type of sponsorship.
 - 7. The potential tax consequences as well as the possible effect on the nonprofit's Section 501(c)(3) status with the Internal Revenue Service (IRS) is between the nonprofit and the IRS.
 - 8. Form HUD-3433 is not required for such cases.

Insurance Upon Completion is an option for new construction and substantial rehabilitation projects financed under Sections 207/223(f), 220, 221(d), and 231. Mortgage insurance is provided after project completion. The following instructions apply to IUC projects:

- A. A financial and credit investigation will be required on the borrower and its principals.
- B. MIP is not included in Form HUD-92264 nor is it charged until the project reaches endorsement
- C. Working Capital and Operating Deficit Escrows. Projects that apply for insurance upon completion must meet the operating deficit escrow and working capital requirements for projects with insurance of advances as outlined below in Section 8.14.E & F, except for the extra 2% construction contingency section of the working capital requirement.
- D. Assurance of Completion is not applicable to IUC projects. At endorsement, the general contractor must satisfy latent defects by:
 1. Setting up a cash escrow deposit equal to 2-1/2 percent of the mortgage, or
 2. Providing a surety bond equal to 10 percent of cost of construction or substantial rehabilitation.
- E. Breakdown of Financing Charges: In IUC projects, before issuance of the Firm Commitment,
 1. The mortgagee must provide:
 - a. A breakdown of financing charges and discounts by submitting Form FHA-2455, Request for Endorsement of Credit Instrument, Certificate of Mortgagee, Mortgagor and General Contractor, with the Certificate of Mortgagee portion completed. The balance of the Form is to be completed before Final Endorsement in lieu of Form HUD-92023.
 - b. Information relative to the construction and permanent interest rates and mortgage term.
 2. Each item is reviewed to ensure its reasonableness in relation to comparable projects and market conditions. The approved fees set to the upper limit for cost certifications purposes.
 3. HUD must inform the mortgagor of the fees that are recognizable for cost certification.
- F. Building Loan Agreement, Form HUD-92441, is not applicable to IUC projects.
- G. Construction Change Orders. The procedure for change orders is the same as in Chapter 13 except as modified below:
 1. Positive change orders in excess of \$5,000. While the mortgagor must be able to provide the additional funds required, an escrow is not required. The mortgagor must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented for insurance.
 2. Approval of the surety is not required when approved changes increase cost by 10 percent or more.

8.14

Determining the Estimated Cash Requirements for Completing the Project

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

- A. Lender's total estimated development cost. Also include the amount by which the:
1. Contractor's and/or mortgageor's estimate for construction exceeds Lender's estimate.
 2. Owner/Architect Agreement for design and/or supervisory services exceeds Lender's estimate.
 3. Consultant's contract for services exceeds Lenders estimate.
- B. Amount necessary to clear all debts on the land (or property if substantial rehabilitation). The Lender must verify all indebtedness. In purchase transaction, include other costs associated with the acquisition that will not be recoverable from mortgage proceeds, i.e., zoning costs.
- C. Estimated cost of offsite improvements and demolition.
- D. Cost of equipping and furnishing a project with non-realty items, if applicable. Use the higher of Lender's estimate or the mortgageor's estimate.
- E. Working capital deposit (new construction/ substantial rehabilitation), if required.
1. There is no increase in the working capital escrow requirements described in the MAP Guide for substantial rehabilitation projects with at least 90% project based rental assistance. For LIHTC projects with a funded working capital reserve held by the partnership (even though controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the increased reserve requirement, although the FHA controlled account must still meet the current working capital escrow requirements as described in existing guidance.
 2. The working capital escrow requirement for new construction transactions will be 4% of the mortgage amount, half of which will be a construction contingency for cost overruns and approved change orders. A separate section to the working capital escrow will govern the 2% construction contingency. The construction contingency portion of the escrow will be refunded to the developer at final endorsement if not used. Change orders funded from the contingency portion of the working capital escrow will not be considered as the basis for a request for an increased mortgage amount.
 3. These funds are not mortgageable and the unused portion will be returned to the Borrower if not needed. See Chapter 12, Section 12.15.C for release of escrow.
- F. Operating deficit, if any.
1. There is no increase in the operating deficit escrow requirements for substantial rehabilitation projects with at least 90% project based rental assistance. For LIHTC projects with a funded operating deficit reserve held by the partnership (even though controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the increased reserve requirements. The FHA controlled accounts must still meet the current operating deficit requirements as described in existing guidance.
 2. For market rate or affordable new construction, and for substantial rehabilitation projects in which there will be significant tenant displacement resulting in negative cash flow during the rehabilitation period, operating deficit escrows will be the greater of:
 - a. What the appraisal and underwriting analysis determines to be appropriate, or

- b. Three percent (3%) of mortgage amount, or
- c. Four (4) months debt service (P&I & MIP) if the property is a garden apartment, or six (6) months debt service (P&I & MIP) if the property is an elevator building where a single Certificate of Occupancy must be issued before any of the units or any of the entire floors can be rented. (See Chapter 17 Underwriting Risk Mitigation for complete guidance).

- 3. HUD will consider lender requests for Initial Operating Deficit draws during lease-up. See Chapter 12, Section 12.16.C for further mitigation guidance.

G. Commitment, marketing fees, and discounts.

H. Cost of issuance to be paid out-of-pocket by the sponsor/mortgagor for tax-exempt or taxable bond financing.

I. Relocation payments not included in Lender's estimated replacement cost on Form HUD-92264-A.

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

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

If land, or "as is" value for a substantial rehabilitation project, is contributed to meet the sponsor's equity requirement, any cash out from the land equity above what is required at initial endorsement must be deferred until the project is complete and it has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy. This does not prevent applying land value equity to fund operating deficit or working capital escrows, or other cash requirements at initial endorsement.

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

8.15

Bond Financed Projects

A. Review of Financing Documents. Financing documents associated with mortgage bonds or tax-exempt bonds are not reviewed. Mortgage bonds are secured by a mortgage on one or more assets. These bonds are typically backed by real estate holdings and/or real property such as equipment. *In a default situation, mortgage bondholders have a claim to the underlying property and could sell it off to compensate for the default.* ?question whether this was the intended term to use? The tax-exempt bond is a security in which the income produced is free from federal, state and local taxes. Most tax-exempt securities come in the form of municipal bonds, which represent obligations of a state, territory or municipality. For some investors, U.S. savings bond interest may also be free from federal income taxes.

- 1. The sponsor must submit, with the application for commitment processing, a separate statement itemizing the estimated costs of issuance, discounts and financing fees to be paid out of pocket by the sponsor/mortgagor and explaining the necessity of each cost.

2. Mortgage Credit.

- a. The Lender's underwriter checks the statement for reasonableness, using the data from previously processed bond-financed projects.
- b. Make adjustment where appropriate.
- c. Uses this information to develop the Total Estimated Cash Requirement Form HUD-92264-A, Supplement to Project Analysis.

B. Loan Rates.

1. ~~If the bond obligations have a variable interest rate, the rate must have a cap that is below the permanent loan rate.~~ The construction loan and the permanent loan rate must exceed the interest rate on the bond obligations. When this occurs, the spread will create a surplus of funds which must be held by the trustee. Any invest income received by the mortgagee but not held for its own account must flow to and be under the control of the bond trustee. The funds cannot flow through the books and records of the project. The bond documents will provide instructions for the trustee. The mortgagor may sue the surplus of funds to cover cost associated with the financing transaction but not recognized in traditional HUD processing. Pay the trustee servicing fee, cure a mortgage default, and prepayment penalty on the redemption of the bonds.
2. In many cases, the interest rate on the bonds is unknown during the commitment process. Therefore, it is not uncommon for the mortgage interest rate to change once the bond interest rate is established. Due to time constraints, if the mortgage rate is lower, HUD may not have sufficient time to reprocess the project. In such cases:
 - a. The Firm Commitment must contain the following condition:

“Any interest savings resulting purely from a differential between the HUD processed interest rate and the actual final interest rate may not be construed as excess funds that may be used to offset costs in other categories at the time of cost certification. Any such savings must be applied as a mortgage reduction.”
 - b. An exception is that savings resulting from the early completion of construction may be used to offset cost certifiable overruns in other cost categories. Compute interest savings by:
 - (1) Recalculating the interest line item on Form HUD-92264, using the actual interest rate for the scheduled construction period.
 - (2) Subtracting the actual interest cost recognized at cost certification from the revised interest figure developed in (1) above.
3. HUD will allow for the inclusion of a total financing and placement fee of 5.5% on bond financed applications, for all MAP eligible Sections of the Act, in determining the replacement cost mortgage amount and a cap of 5.5% recognized at cost certification.

C. Bonds may be sold at a premium to investors, i.e., investor pays an amount in excess of the face

value of the bonds. The premium results from the bonds carrying a higher coupon rate than is generally available in the marketplace.

1. Traditionally, HUD does not look at the mortgagee's cost of funds. Any premium raised by a transaction is considered part of the mortgagee, bond underwriter, or issuer's profit. However, if a mortgagee gives something of value without the expectation of being repaid, HUD considers this to be a kickback. The one exception involves tax-exempt bond transactions where the issuer of the bonds may permit the mortgagor to receive some portion of the premium. In this situation, the mortgagee, bond underwriter and issuer are simply conduits for the transfer of funds.
 2. If any of the premiums is returned to the mortgagor, it is considered excess investment income and is treated as project income and used to reduce the total allowable cost of the project.
 3. For **all** MAP eligible Bond Financed Projects, the premiums may be treated as project income under the following conditions:
 - a. The sponsor/mortgagor entity cannot benefit monetarily from the excess investment income.
 - b. The premium, if given to the sponsor or mortgagor entity it controls, is considered as excess investment income.
 - c. Closing documents must detail the amount of the premium being given to the sponsor or the mortgagor entity it controls.
 - e. The premium may be used to pay for additional cost associated with the cost of issuance and may be applied to other recognizable cost overruns.
 - f. The mortgagor's accountant for an audited cost certification, or the mortgagor for an unaudited cost certification, must detail in the notes to the financial statement the amount of excess income received.
 - 4.** On nonprofit applications, excess income generated from premiums may be applied to recognizable cost overruns. Any excess income over and above that used towards recognizable cost overruns must be transferred to the reserve for replacement account.
 - 5.** On Section 223(f) applications, excess income generated from premiums must be transferred to the reserve for replacement account, as there are no cost overruns.
- D. Itemized Statement of Costs. Attached to and reflected in the Mortgagee's Certificate, Form HUD-92434, is an itemized statement of the costs of issuance of the obligations, discounts, and financing fees paid through the mortgagee.
1. The statement must explain why each individual item is necessary for the issuance of the obligations.
 2. Review the amount of each item to ensure its reasonableness in relation to comparable projects.

3. HUD will prepare a letter from the HUD Hub/Program Center Director informing the mortgagee that HUD will recognize for cost certification purposes the costs of issuance, discounts, and financing fees in an aggregate amount not to exceed 5.5% included in the mortgage for all MAP eligible programs.
 4. The mortgagee, bond underwriter, and issuer have the option of deferring collection of additional discounts, financing fees, slow draw fees, etc., through the provision of Paragraph 18(f) of the Mortgagee's Certificate (Form HUD-92434).
 - a. The deferred collection of these items must be an obligation of a third party. Both the third party and the mortgagee bond underwriter or issuer must attest in writing that they will not look for payment from:
 - (1) Mortgagor;
 - (2) Mortgaged property;
 - (3) Mortgage proceeds;
 - (4) Any reserve or deposit required by HUD and/or mortgagee in connection with the mortgage transaction; or
 - (5) Rents or other income from the mortgaged property.
 - b. The mortgagor entity may issue, as evidence of the debt a surplus cash or residual receipts note to the third party for costs identified in Paragraph 4 above which HUD determines to be reasonable.
- E. Pre-Cost Certification Conference Information. Explain at the pre-cost certification conference that:
1. The net effect of negative interest arbitrage (capitalized interest) may be recognized if there are offsetting savings in the mortgage.
 2. Any rebate to the sponsor/mortgagor from the mortgagee, issuer, or bond underwriter automatically reduces the mortgage at cost certification. The following are two samples of the most common types of rebates.
 - a. Mortgagee/bond underwriter contributes a portion of the initial service charge that was collected to pay discounts or other fees.
 - b. Mortgagee/bond underwriter refunds a portion of the construction loan interest to the mortgagor or sponsor.

8.16**Lender's Review and Recommendation**

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

- A. The report must detail the project's financial requirements and the credit capacity of the sponsors, mortgagor entity, its principals and general contractor. The report must detail the project's financial feasibility with an analysis of the primary risks and mitigates the owner has in place and the rationale for any waivers requested. The Lender's underwriting analysis must contain compelling evidence of the determined financial feasibility of the single asset entity and each principal with decision making control and providing money for initial closing and the entire construction period. Include, at a minimum:
1. Name of the mortgagor entity.
 2. Composition of the mortgagor entity, include the tiers showing principals with control and providing the financing.
 3. Name of general contractor, disclosing relationship(s) with mortgagor entity.
 4. Mortgage amount and controlling criterion.
 5. Financial requirements for closing.
 6. Sources of funds to meet cash requirements. Include all sources and disclose how the money will be used.
 7. The experience level of the development team relative to the proposed project.
 8. A credit and financial review of sponsor(s) mortgagor and principals and general contractor. This review must address positive and negative findings known by the Lender.
 9. Bonding requirements.
 10. Recommendation to accept or reject.
 11. If accepted, any conditions to be included in the commitment.
- B. Completed Form HUD-92264-A and exhibits for the type of mortgage proposed must be submitted to HUD.
- C. The Lender will transmit to HUD all mortgagor submissions and related documents.

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

- A. Receiving HUD Approval to Participate in HUD Programs Previous Participation Certification:
1. Principals of projects applying for mortgage insurance under HUD programs are subject to HUD approval based upon their experience and participation in previous HUD projects. The Active Partners Performance System (APPS) will allow HUD's business partners to submit their Previous Participation Certification (Form HUD-2530) request to HUD for processing via the Internet. APPS also will allow HUD staff to review and approve/disapprove 2530 submissions on-line via the HUDweb. So that the collection of information and the

review/discussion process are more efficient HUD has added two additional Internet servers to enhance performance and traffic movement through the HUD systems' secure firewall.

All participants required to apply for previous participation clearance must do so through APPS. Although paper submissions are being accepted it is HUD's preference that the clearance process begins via the HUDweb. Participants must complete baselines in APPS if they wish to pursue participation clearance. Baselines allow an organization to identify their principals and previous participation. To learn more about APPS, getting registered, accessing the user guide and using the tutorial please visit us at <http://www.hud.gov/offices/hsg/mfh/apps/appsmfhm.cfm>.

The electronic 2530 Participant Certification will now take the place of Form HUD-2530, Previous Participation Certification. HUD staff will review the Electronic 2530 Participant Certification to establish the percentage of ownership interest, if any; the principal will have in the proposed project. In addition, a review will be made of the principal's or participant's role in and status of previous projects. Principals must disclose any defaults, mortgage relief, assignments, and foreclosures relating to these projects.

2. HUD will advise the mortgagee of its findings. If HUD rejects a principal their withdrawal does not necessarily result in a rejection of the application. HUD will determine if the remaining principals can successfully proceed with the project.
- B. HUD will review the Lender's Underwriter's Narrative Report and the HUD-92264-A to determine the following:
1. The acceptability of the sponsor, mortgagor and its key principals, and the contractor.
 2. The maximum insurable mortgage.
 3. The total financial requirements for settlement.
- C. HUD will verify, through use of the HUD-92264-A and documents supplied by the Lender, the source(s) of funds to meet cash requirements.
- D. The HUD technician responsible will forward their recommendations (Format in Appendix 8A) to the Team Leader.

SUMMARY OF MAJOR CHANGES IN CHAPTER 9 OF THE MAP GUIDE

Environmental Review

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>.

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgagee letters and HUD notices issued prior to 2000.

Specific Chapter 9 revisions in the new release:

- Section 9.2, which formerly covered only the qualifications of environmental professionals, now covers procedures. The HUD staff is responsible for preparing both the Sample Field Notes Checklist and Form HUD 4128, the Environmental Report. There is a new requirement that the evaluation of site contamination be submitted with the pre-application report except in the circumstances where the lender is filing directly for a Firm Commitment, thus by-passing the pre-application stage.
- Major changes were made to Section 9.3, "Phase I and Phase II Environment Site Assessment (ESA)." The substantial expansion of that section includes the requirement that the environmental professional firm conducting the Phase I must base its site analysis on the guidelines in the listed publications of the American Society of Testing Materials (ASTM). The steps described for remediation of hazards include the Phase I ESA and Phase II ESA, as does the present chapter, but the revised chapter includes a new test that has been developed since the MAP Guide was revised in 2002: a vapor intrusion screen analysis must be done prior to Firm Commitment.
- New to this Section 9.3 of the MAP Guide is a discussion of remediation plans in subsections C through F. Initially, the effort should be made to bring the contamination to minimum levels prior to Firm Commitment. The second plan describes a Risk-Based Corrective Action

(RBCA) which is designed for incomplete removal of contamination until after initial endorsement. An RBCA usually requires engineering controls and monitoring wells. The lender in a RBCA often frequently establishes an escrow account to cover the cost of an operating and maintenance plan for the engineering barriers created under the RBCA. Tenants must be notified that the process of remediating existing contamination is underway.

- Lenders have criticized several provisions of the existing Chapter on environmental review; the new Chapter makes some changes which should eliminate these criticisms.

a) Monitoring wells (discussed in new Section 9.3.F)

The existing Chapter 9.3.F states that properties with testing, flushing, or monitoring wells in operation may be evidence of site contamination, and they will not be considered for mortgage insurance. Field offices have been advised that they can waive that prohibition for good reason, but lenders and developers may not realize that waivers may be available. The revised Chapter 9.3.F states that the presence of a testing or monitoring well on the property does not bar the property from consideration for mortgage insurance.

b) Capping (discussed in the revision of Section 9.3.E.6)

The existing Chapter 9.3.E states that HUD will not accept property for firm commitment where a site contamination problem has been capped or paved over. The revised Chapter describes the use of engineering controls (9.3.E), such as concrete or slurry walls, for risk-based corrective actions (RBCA). For example, the concrete surface of a parking lot can protect the tenants from underground contaminated water, but the chapter requires an operations and maintenance program for as long as fifteen years because the parking lot surface may deteriorate or be replaced during the 30 or 40 years that HUD insurance is in force.

c) No Change in Review of State Decisions

The new Chapter does not make a change in another provision that some lenders have criticized: If a remediation plan is approved by a state environmental agency, or if the state agency maintains that the extent of contamination is insufficient to pose a hazard, some lenders believe that the state decision on the risk should govern HUD's decision. They object to the provision in the Chapter 9.1.A that "HUD's requirements may exceed those of many state agencies. One reason for this is that, if a mortgagor defaults on an FHA -insured project, HUD may become the project owner". Under Federal law, federal agencies are required to take all remedial action necessary to protect human health and the

environment. If HUD is assigned the property, it may not transfer the property without removing all Recognized Environmental Concerns (RECs), (the phrase used to describe site contamination). This provision from the original version of Chapter 9 has not been changed.

d) Reliance on ASTM guides

The revised Chapter 9 lists the American Society of Testing Materials (ASTM) Practices and Guides that should be followed by the developer's environmental professional. An environmental contractor will have the ASTM documents, but the Hubs and Program Centers are not expected to purchase these Practices and Guides.

e) Remediation. Costs may sometimes be included in the mortgage.

Remediation for site contamination was covered in a paragraph in the original Chapter 9. Under the new Chapter, the remediation plans are discussed in separate sections. The RBCA must be completed, and the site must be tested and approved by the governmental authority (usually the State) prior to Initial Endorsement. Section 9.3.C, subsections 8 (a) and (b), however, states that if there is ongoing remediation and the extent of contamination can be definitely determined and the cost can be specified for an approved remediation plan, the applicant can show why the work should be done in the period between Initial and Final Endorsement.

Where a remediation plan allows for incomplete removal of site contamination, there is a section discussing natural attenuation and passive remediation of site contamination. There is also a separate discussion of escrow accounts which must be set up for the maintenance of engineering controls.

The basic practice has been and that any necessary remediation as determined by the environmental site assessment should be completed before Initial Endorsement and the costs cannot be included in the mortgage. Under this new guidance, the remediation cost can be determined and agreed upon, and the costs are reasonable for the extent of work and do not subject the Department to unacceptable risk, then the costs after Initial Endorsement may be included in the construction costs, subject to review by the Hub or Program Center. For example, the lender and the environmental professional may inform the processing office before commitment that an underground storage tank must be removed, but tests have determined that there is no leakage from the tank. HUD may decide that based on this limited risk that it would be permissible for the tank to be removed during the construction period, rather than prior to the Firm Commitment.

- A new section is entitled Section 9.4, Field Personnel Responsibilities in Reviewing Cases Requiring Remediation. It outlines the role of HUD staff in development, Section 9.5. The Environmental Report does not include site contamination, but it does include the 12 items in the environmental report. In addition if the apartment building was built or substantially rehabilitated before 1978, lead-based paint and asbestos are concerns. Frequently, asbestos and lead-based paint, dating before 1978, has already been removed.

- The sections on asbestos and lead-based paint have been expanded. Procedures for noise, floodplain management, and the remaining topics in the report have not been changed from the original chapter.

Chapter 9

Environmental Review

9.1**Introduction**

This chapter outlines for the Lender and HUD staff the policies and procedures that the HUD staff must follow to meet environmental responsibilities. Section 9.1 covers the Legal Authorities, HUD Forms and professional Qualifications. Section 9.2 covers the procedures to be followed for environmental processing. Section 9.3 discusses Contamination analysis including factors such as Environmental Site Assessments (ESA), Recognized Environmental Conditions (REC), and remediation plans. Section 9.4 sets forth the responsibilities for the Department's Hub/Program Center staff pertaining to issues that involve remediation. This Section outlines how the cost of remediation can be determined and included in the HUD-insured mortgage. Section 9.5 points out environmental concerns (other than soil contamination) which often have to be addressed by HUD staff in processing the form HUD 4129 as well as other "environmental factors" that should be included in the required lender's Environmental Report.

It should be noted that Office of Insured Health Care Facilities (OIHCF), which now manages the Section 232 program, will utilize this chapter in completing environmental processing for Section 232 applications.

A. Legal Authorities, Handbooks, and Forms

1. All Federal agencies are required to comply with the National Environmental Policy Act of 1969 (42 U.S.C. 4321 et seq.) (NEPA), and the implementing procedures issued by the Council on Environmental Quality at 40 CFR Parts 1500-1508. HUD regulations implementing NEPA are contained in 24 CFR, Part 50, "Protection and Enhancement of Environmental Quality". Related Federal laws and authorities are listed in 24 CFR 50.4 and

40.3(i). HUD may not delegate its environmental responsibilities to others; it is required to prepare the environmental assessment and make the appropriate environmental finding. (See 24 CFR 50.11.)

2. HUD has issued two handbooks covering environmental issues: Handbook 1390.2,

“Environmental Assessment Guide for Housing Projects”, and Handbook 1390.4 “Guide to HUD Environmental Criteria and Standards contained in 24 CFR 51”. Informal guidebooks issued by HUD on environmental issues are cited in this chapter. In addition, HUD offices may make the Guide, “Choosing an Environmentally Safe Site”, which is used in the Section 202 and 811 programs, available to all projects.

3. HUD has established an environmental form HUD-4128, “Environmental Assessment and Compliance Finding for Related Laws” that documents compliance with NEPA, and other environmental Federal laws, authorities, Executive Orders, and HUD standards. Form HUD-4128, with attached Sample Field Notes Checklist (SFNC) may be retrieved electronically from HUDClips. HUD staff will use the SFNC to provide information supporting the conclusions listed on form HUD-4128. Existing apartment projects to be refinanced under Section 223(f) do not require an environmental assessment under the National Environmental Policy Act (Part B of form HUD-4128) except in extraordinary circumstances (see exclusion in 24 CFR 50.20(a)(5)), but do need to comply with Part A requirements of form HUD-4128. It is important to note that the Environmental Site Assessment (ES), which are performed as part of contamination analyses in Section 9.3
4. HUD’s requirements in this chapter may exceed those of many State agencies. One reason for this is, if a mortgagor defaults on an FHA-insured project, HUD may become the project owner. Under Section 120(h) of the Comprehensive Environmental Response and Liability Act (CERCLA) Federal agencies that own properties are required to take “all remedial action necessary to protect human health and the environment”. This requirement is beyond any liability releases under State or Federal law and any due diligence requirements under CERCLA.

B. State Local or Tribal Laws

1. In cases where state or local laws, tribal laws, ordinances, codes or regulations are more restrictive than Federal requirements, the applicant will be responsible for compliance with the stricter local or state standard unless Federal law states otherwise. An Application for FIRM Commitment for mortgage insurance does not relieve an owner of responsibility for compliance with state or local requirements.
2. HUD will not assume any responsibility with respect to inspection, enforcement, interpretation or determination of compliance with such state or local requirements.
3. Where the project is located on a Native American reservation, the tribal authority may have the responsibilities of the State or local environmental protection agencies. In the

Contamination Analysis discussion in Section 9.3, the acronym LSTF refers to “local, state, tribal or federal”.

4. This chapter is not a substitute for requirements in the laws, regulations, and Executive Orders regarding environmental analysis.

9.2

Procedures

A. Lender’s Responsibilities

1. All projects (new construction, substantial rehabilitation, refinancing or purchase submitted under MAP require various submissions related to Contamination as stated in detail in Section 9.3.
2. Additionally, the Lender must also provide an Environmental Report to HUD staff as discussed in Section 9.5. The Environmental Report will identify any significant environmental issues to be resolved, and will help HUD staff in its preparation of the Form HUD 4128 and SFNC. The Lender should use the criteria included in the SFNC and the criteria included in Section 9.5 as a format for the information to be provided in the Environmental Report.

B. HUD Staff Responsibility

1. In accordance with 24 CFR 50.32, HUD, not the Lender, is responsible for preparing the form HUD-4128 and SFNC and determining that there are no environmental factors that are prohibited by law, Executive Order, or regulation, or which would endanger health or safety, or would put FHA mortgage insurance or the U.S. Government at financial risk or liability.
2. HUD staff must review the Phase I Environmental Site Assessment (ESA) (see Section 9.3.A, below) submitted by the Lender and must make a site visit. The site visit will help validate part of the information provided on the Phase I ESA and it also should be useful for evaluating other environmental factors. A HUD appraiser and/or FECO customarily make the site visit and sign-off on the form HUD 4128 and SFNC. The Hub Director or Program Center Director, who issues the commitment, is responsible for signing form HUD 4128.
3. 24 CFR 50.32 also require that a NEPA Environmental Assessment for a project with more than 200 apartment units or 200 beds shall be sent for review and comment to the appropriate Field Office Environmental Clearance Officer (FECO). The FECO must also be

given the opportunity to review and comment on any environmental assessment in which the project is in the normally unacceptable or the unacceptable noise zone. Projects such as those insured under Section 223(f), that are deemed to be categorically excluded from NEPA, but requiring compliance with the Federal laws and authorities cited in 24 CFR 55.4, pursuant to 24 CFR 50.20(a) do not require review and comment of the FECO, but it is recommended that they be given the option when special analysis is required under such laws and authorities.

4. As part of its environmental review responsibilities, HUD may require additional environmental material from a lender, such as a Phase II ESA (see Section 9.3.B, below), even when the lender might not believe that such additional environmental material is necessary.
5. For lenders that follow the pre-application process, HUD staff will not be required to, and will generally not complete the Form HUD 4128 until after submission of the application for the Firm Commitment. However, close coordination at the pre-application stage between the Lender and the local Processing Center will expedite completion of this process when the application for Firm Commitment is made, with all issues resolved and agreed upon in advance.
6. Environmental conditions, which must be addressed prior to submission of an Application for Firm Commitment, will be discussed in the letter of invitation for Sections 207(m), 221(d)(3) and (d)(4), 220, and 231. Any requirements that affect project design will be fully detailed. The Lender must assure that any requirements affecting project design are conveyed to the design architect for incorporation into the contract drawings and specifications.
7. HUD Staff should refer to the specific directions and guidance contained in Section 9.4 for projects that involve remediation and or monitoring.

C. When to Submit Required Exhibits to Resolve Environmental Issues

1. For lenders that use the pre-application process for new construction or substantial rehabilitation proposals, rather than going directly to Firm Commitment submission, HUD requires various submissions regarding contamination pursuant to Section 9.3 and the Environmental Report pursuant to Section 9.4 so that HUD can determine that all environmental issues can be resolved at the Firm Commitment processing stage. The purpose of asking for certain documents at the pre-application stage is to help make an early evaluation of any environmental issues to be resolved. It does not mean that all the documentation required for environmental review need be submitted at the pre-application stage. Important issues should be resolved at the pre-application stage, with documentation

on the issues submitted with the Application for a Firm Commitment. The letter of invitation will condition the issuance of a Firm Commitment upon a finding on the form HUD-4128 that there are no unresolved environmental concerns.

2. Lenders that at their option go directly to Application for Firm Commitment are required to submit all the exhibits necessary to resolve any environmental issues.
3. Remediation of site contamination is discussed in Section 9.3 of this chapter. The implementation of plans which provide a remedy to other environmental conditions may, with HUD approval, continue throughout the construction period. The Lender must identify any plan for the cure of any environmental problems which will not be solved by the time the Application for a Firm Commitment is submitted. HUD will review the Lender's plan and, if HUD considers the plan acceptable, make the plan a condition that is set forth in the Firm Commitment letter. This would include any plans for remediation of soil contamination, wetlands mitigation, noise abatement, historic preservation, and/or floodplains map revisions.
4. Removal or containment of lead-based paint or asbestos may continue beyond initial and final endorsement if HUD agrees.

D. Qualifications of Professionals

1. The sponsor/developer will generally select the professionals to be used to prepare the Environmental Report, the Phase I Environmental Site Assessment (ESA), or any other environmental information required by HUD, but the Lender should verify that the professionals used are qualified for their assigned responsibilities. The Environmental Professional preparing the Phase I ESA must meet all of the qualification requirements of Appendix X2 of ASTM E 1527-05. Additionally the environmental professional must meet the license/certification, educational, and experiential requirements of Section X.2.1.1(2)(i), (ii), or (iii), of Appendix X2 of ASTM E 1527-05. The environmental professional must describe how she/he meets these qualifications in the Qualification(s) of Environmental Professional(s) Section of the Phase I ESA. For "relevant experience" such discussion must be specific as to how the requirements of Section X.2.2 of Appendix X2 of ASTM E 1527-05 have been met. . An example of an insufficient discussion of relevant experience would be stating that he/she performed sample analyses in a laboratory along with writing associated reports, unless the discussion indicated an "understanding of surface and subsurface and subsurface conditions" and the "development of opinions regarding conditions indicative of a release or threatened release."
2. The Phase II ESA (see Section 9.3.B, below) and remediation studies and plans (see Section 9.3 C, D and E, below) must only be completed by an environmental investigator(s)

specifically qualified to meet the responsibilities for the issue(s) of concern. Such qualifications must be stated in the Phase II ESA Report or the remediation studies and plans, respectively.

3. Other professionals may be required to evaluate technical areas, such as flooding or soil stability conditions. The Lender should assure itself that these technicians are qualified. When these professionals are required, the Lender may contract for those services, if the sponsor/developer has not done so.

E. Consulting with the Hub or Program Center

HUD encourages Lenders to consult early with field office staff on HUD environmental requirements. Local conditions and interagency relations affecting environmental review requirements differ from State to State and from field office to field office. For instance, coastal zone management requirements are not applicable in most States, but in States where they are applicable, procedures for showing compliance differ. In some States, a letter from the State coastal zone management agency for projects in the coastal zone is required. In others, alternative review procedures make this unnecessary.

9.3

Contamination Analysis: Phase I and Phase II Environmental Site Assessments, and Remediation

This first revision to Section 9.3 is appropriate in light of the many changes to the art, science, and governmental standards of hazard remediation that have taken place since the issuance of the original version of this section in 2000. While the original version had required removal of any identified contamination, this revision allows for managed care of contamination, but only with measured due diligence.

The purpose of this chapter is to first, identify any manmade contamination on a site, other than contamination from in-place building components such as asbestos containing materials or lead-based paint; and second to ensure that any contamination so identified, is mitigated to the point where it would be unlikely to “affect the health and safety of occupants or conflict with the intended utilization of the property” as stated in HUD-wide policy at 24 CFR 50.3(i)(1).

A. Phase I Environmental Site Assessment (ESA)

1. Submission. With the request for a pre-application review, or if the pre-application stage is omitted, the MAP Lender shall submit a complete Phase I ESA. A summary submission is

not acceptable. When there is no pre-application stage, any references thereto in Section 9.3, shall instead refer to the Application for Firm Commitment. The MAP lender and/or its proposed mortgagor must inform the Phase I ESA Professional preparer of all of the following additional Phase I ESA requirements:

- a. Purpose. It is a general industry practice to prepare a Phase I ESA to make an initial determination as to the potential occurrence of “hazardous substances” as generally defined by CERCLA, and of petroleum and petroleum products. However, HUD requires an initial determination not for CERCLA purposes, but rather as a part of the Department's overall environmental responsibilities pursuant to 24 CFR 50.3(i). This purpose must be described in the “Purpose” subsection to the required “Introduction” Section of the Phase I ESA (see Section 9.3.A.1.b, below).
- b. Phase I ESA format. The Phase I ESA must be prepared in accordance with the requirements of ASTM E-1527-05 “Standard Practice for Environmental Site Assessments, “Phase I Environmental Site Assessment Process.” using the table of contents and report format specified in Appendix X4, thereto.
- c. Phase I ESA Timing. The Phase I ESA shall be conducted (meaning the earliest of the date of the site visit, records review documents, or interviews) within one-year of the submission date to HUD. However, a Phase I ESA that was conducted more than 180 days prior to the submission date to HUD, but within the allowable one-year period, must be updated pursuant to Section 4.6 of ASTM E 1527-05. A Phase I ESA originally prepared more than one year prior to submission to HUD, even one updated within 180 days of being submitted to HUD, is not acceptable.
- d. Phase I ESA Professional Preparers Qualifications. The Qualifications of Environmental Professionals section of the Phase I ESA (see Section 9.3.A.1.b above) must describe the Professional’s qualifications as described in Section 9.2D.1 above.
- e. Finding Section. The Findings section of the Phase I ESA (see Section 9.3.A.1.b), must list obvious Recognized Environmental Conditions (REC), suspected or potential RECs as determined from statements made in earlier sections in the Phase I ESA, Historical Recognized Environmental Conditions (HREC) (see Section 9.3.B.7) and de minimis conditions (such as minor soil staining). (Also, see Section 9.3.B.10.)
- f. Opinion Section. The Opinions Section (see Section 9.3.A.1.b, above) pursuant to Section 12.6 of ASTM E 1527-05, must discuss each finding from Finding Section (see Section 9.3.A.1.e, above) and whether or not it is a REC. The justification for any finding deemed not to be a REC must be included in the Opinions section. If the Phase I ESA preparer cannot make a statement as to whether a condition is or is not a REC, the

Opinion Section must state what information or further investigation would be deemed necessary to make such a determination. When previous remediation has been performed or is ongoing - i.e., not yet an HREC (see Section 9.3.A.1.e, above)-- at the proposed site, the Phase I ESA must fully discuss the extent of such remediation in this section of the Phase I ESA, including any involvement from local, State or Tribal, and/or Federal environmental (LSTF) Authorities. The Phase I preparer shall state with justification as to whether such ongoing remediation should resolve any RECs or undecided issues identified in the Phase ESA.

Note: Even if the Environmental Professional preparing the Phase I ESA, determines that a Finding made in Section C.1 does not rise to the level of a REC, HUD may nevertheless determine that indeed, there is a REC.

- g. Conclusions Section. The Conclusions Section (see Section 9.3.A.1.a, above) pursuant to Section 12.8 of ASTM E 1527-05 regarding a determination of a REC, must include one of the two quoted statements therein.
- h. User Provided Information Section. The applicant and the current property owner, if different from the applicant, shall complete the User Questionnaire(s) as per Appendix X3 of ASTM E-1527-05. The environmental professional preparing the Phase I ESA shall incorporate the User Questionnaire(s) in the "User Provided Information Section" of the Phase I ESA (see Section 9.3.A.1.b, above) and shall take into account any information provided in the User Questionnaire(s) in the preparation of the Phase I ESA.
- i. Testing not required. The Map Guide's Phase I ESA does not require testing which is performed during the course of a Phase II ESA or as part of a remediation plan (see below). However, the Phase I ESA may reference and discuss a prior Phase II ESA in regard to concluding whether or not a condition is a Recognized Environmental Condition (REC).
- j. Vapor Encroachment Screen. The Phase I ESA **must include** an initial vapor (a.k.a. gas) encroachment screen to determine if there is a potential for vapors to occur in the subsurface below existing and/or proposed on-site structures from those hazardous substances, petroleum, and petroleum products that consist of volatile organic compounds (VOC) and semi-volatile organic compounds (SVOC) and inorganic volatile compounds. The initial vapor encroachment screen amendment to the Phase I ESA shall be performed using Tier 1 "non-invasive" screening pursuant to ASTM E 2600 - 10 "Standard Guide for Vapor Encroachment Screening on Property Involved in Real Estate Transactions," Section 8" If the tier 1 vapor encroachment screen determines that , as indicated in ASTM E 2600-10, Section 8.7.1, there is a "vapor encroachment condition" (VEC) which is the "presence or likely presence" for such vapors to occur in the subsurface below existing and/or proposed on-site structures, a likely VEC, or that a

VEC “cannot be ruled out”, it shall also be deemed to be a REC for purposes of the Phase I ESA.

- k. Previous Remediation. When previous remediation has been performed, or remediation is currently taking place, the Phase I ESA must fully document such remediation, including any involvement from local, State or Tribal, and/or Federal environmental (LSTF) Authorities.

- b. HUD’s Evaluation of the Phase I ESA. The Phase I ESA will be evaluated by HUD to determine if the property is acceptable for the hazards reviewed. If it is unacceptable because it shows an identifiable hazard, i.e. a REC, as described in ASTM E 1527-05, and no corrective action is deemed feasible by HUD, then HUD may reject the property.

B. Phase II ESA

1. Purpose. The purpose of the Phase II ESA is to provide and investigate specific technical issues and report on them, based on testing, sampling, etc., to confirm the identity of suspected contaminants, and/or to quantify the extent of an observed or suspected liability, such as underground storage tanks (UST), or surface or ground water contamination.
2. Timing. The Phase II ESA shall be submitted at the same time as the Phase I ESA.
3. When Required. A Phase II ESA is required if;
 - a. The Phase I ESA indicates that there is a REC and corrective action is potentially feasible, or
 - b. The Phase I ESA comes to no definite conclusion regarding the presence of a REC, or
 - c. HUD requires a Phase II ESA for reasons that must be described to the Lender.
4. Exception to Submission Requirement. In some cases and with HUD permission, the Phase II ESA may be bypassed for remediation which is described Sections 9.3.C, D, and E below).

5. Standards to be used. The Phase II ESA **must** conform to the most current version of ASTM E 1903 (currently 1903-97), “Standard Guide for Environmental Site Assessments: Phase II Environmental Site Assessment Process,” as amended.

Furthermore, the Phase II ESA must describe the methodology, data and sampling procedures used in the process, in addition to any relevant tests or laboratory results. Lesser degrees of site assessments or non-conformance are not acceptable. (ASTM is in the advanced stages of revising ASTM E 1903, which then will become the required version under this Notice.)

The Phase II ESA should also conform to the following ASTM Practices and Guides, as deemed appropriate by the environmental investigator:

- a. D 6235-04, “Practice for Expedited Site Characterization of Vadose Zone and Ground Water Contamination at Hazardous Waste Contaminated Sites”
- b. E 1689-95 “Standard Guide for developing Conceptual site models for Contaminated Sites”
- c. E 1912-98, “Guide for Accelerated Site Characterization for Confirmed or Suspected Petroleum Releases”

The Phase II ESA **must** describe, as applicable, which, if any, of these three ASTM Standards to which the Phase II ESA also conforms.

6. New Construction or Substantial Rehabilitation Projects using Pre-application. For new construction or substantial rehabilitation using the pre-application process, the Phase II ESA, if required, shall be submitted by the Lender at the pre-application stage and must be reviewed by HUD before an invitation is issued to submit an Application for a Firm Commitment
7. Historical Recognized Environmental Conditions (HREC). If the Phase I ESA indicates that there is a HREC, as described in ASTM E 1527-05, i.e., a hazard has been remedied and an LSTF Authority has issued a no further action (NFA) letter or similar approval, HUD may for its purposes either deem the NFA as completion of the remediation or it may require a Phase II ESA and/or further remediation.
8. Horizontal and Vertical Extent of the Study. The Phase II ESA usually need not determine the total horizontal and vertical extent of contamination, but must proceed to a point where it indicates the location of hot spots of greatest concentration and risk.
9. Vapor Encroachment/Vapor Intrusion. If it is determined that there is a potential for vapors to occur in the subsurface below existing and/or proposed on-site structures either

identified from the Phase I ESA as a REC (see 9.3,A.1.j above) or from this or prior Phase II ESAs, the Phase II ESA shall include either a tier 2 vapor encroachment screen pursuant to ASTM E 2600-10, Section 9, a vapor intrusion assessment (VIA) pursuant to LSTF policy and/or procedure (as discussed in ASTM E 2600-10, Appendix X7.1), or go directly to Tier 4 “mitigation” (as discussed in ASTM E 2600-10, AppendixX7.2).

If a Tier 2 screen was performed and it determined that there was a VEC, a likely VEC, or that a VEC could not be ruled out, either a vapor intrusion assessment (VIA) pursuant to LSTF policy and/or procedure (as discussed in ASTM E 2600-10, Appendix X7.1), or Tier 4 “mitigation” (as discussed in ASTM E 2600-10, AppendixX7.2) is required.

If a VIA was performed, any mitigation (remediation) deemed necessary would have to follow LSTF policy and/or procedure.

10. Phase II conclusion regarding current existence of on-site contamination. The Phase II **must conclude** that
 - a. It has failed to confirm the presence of contamination or identifies only de minimis levels of contamination on the site. For purposes here, de minimis means that any contamination that is present is not be considered to be a health, safety, or environmental risk, without the need for engineering or institutional controls and usually the equivalent of a Statewide, non-site-specific level, sometimes called a tier I level or method A level and if there is some question as to whether the contamination is deemed as de minimis, a determination is required from the appropriate LSTF authority.
 - b. Contamination exists on the site above de minimis levels, including a discussion of the vertical and horizontal extent of such contamination.
11. Off-site contamination conclusion. Regarding the risk of off-site contamination migrating on to the proposed site, Phase II ESA preparer **must indicate** whether:
 - a. There is no known or perceived off-site contamination in the vicinity of the proposed site.
 - b. It is unlikely that any known or perceived off-site contamination will migrate on to the site.
 - c. It is likely that known or perceived off-site contamination will migrate on to the site.

12. The Phase II ESA must describe how it conforms to any applicable LSTF requirements
13. The Phase II ESA must be prepared in the form of a report which includes a detailed, common language summary.
14. Exception of requirement for Phase II preparation and submission for ongoing remediation. A Phase II ESA is not required when remediation is ongoing to the point of not yet being an HREC (see Section 9.3.A.1.e, above), if the Phase I Environmental Professional states that such remediation should resolve any RECs and undecided Phase I ESA issues (see Section 9.3.A.1.f, above) and if the **remediation plan** preparer (see Section 9.3.C, below) indicates that all of the above Phase II ESA requirements have been met.

C. Remediation Plans - General

Remediation Plans are required if the Phase II ESA cannot conclude per Section 9.3 B.10.a, and B.11.a and B.11b.

The following requirements apply to all remediation plans:

1. Complete site characterization.
 - a. Anytime a site has been identified from a Phase I or Phase II ESA (see Sections 9.3A or B, above) as having contamination (or contamination exposure pathways), be it vapor (gas), liquid, solid, dissolved, or non-aqueous phase liquid (NAPL), above de minimis levels, a complete site characterization (sometimes known as special site assessment report, a detailed Phase II ESA, or even a Phase III ESA) must be prepared as the initial step of any remediation plan.
 - b. It must determine the total horizontal and vertical extent of such contamination, exposure pathways, and potential receptors (a.k.a., conceptual site model). However, if the remediation plan preparer determines that the Phase II ESA preparer has already determined the total horizontal and vertical extent of such contamination, exposure pathways, and potential receptors, then such determination shall be so indicated and the Phase II ESA shall be made a part of the remediation plan.
 - c. It must be based on the appropriate combination of the following ASTM Practices and Guides, as amended, as determined by the remediator's environmental investigator.

Lesser degrees of site assessments or non-conformance are not acceptable. These ASTM Practices and Guides are as follows

- i. D 6235-04, "Practice for Expedited Site Characterization of Vadose Zone and Ground Water Contamination at Hazardous Waste Contaminated Sites"
 - ii. E 1689-95 "Standard Guide for developing Conceptual site models for Contaminated Sites"
 - iii. E 1903-97, "Standard Guide for Environmental Site Assessments: Phase II Environmental Site Assessment", as amended
 - iv. E 1912-98, "Guide for Accelerated Site Characterization for Confirmed or Suspected Petroleum Releases"
 - d. All of the requirements of Section 9.3.C.2, 3, and 4 (below) must be met.
 - e. It must discuss how it meets with the appropriate Practices or Guides, listed here, and/or the appropriate LSTF procedures.
 - f. It must indicate how it meets the requirements of any applicable LSTF regulatory procedures
2. Any remediation studies and plans must be prepared in the form of a report which includes a detailed, common language summary and discusses how it meets with the appropriate Practices or Guides, listed here, and/or the appropriate LSTF procedures.
 3. Any remediation studies and plans must be presented to HUD at the same time as the Phase I ESA and, if applicable, Phase II ESA.
 4. The remediation plan preparer qualifications as described in Section 9.2D.2, above, must be discussed in any remediation reports.
 5. Submission of remediation plan including the site characterization as described in Section 9.3.C.1, above. For lenders using the pre-application process the remediation plan must be submitted at the pre-application stage, and must be reviewed by HUD before an invitation is issued to submit an Application for a Firm Commitment. Evidence of approval by the LSTF Authority must be submitted with the Application for firm commitment.

6. The remediation plan must cover all relevant contaminant phases: vapor (gas), liquid, solid, dissolved, and NAPL.
7. Remediation Timing - Uncertain Determination of Cost and/or Effectiveness of Remediation. If HUD determines that it is uncertain whether or not implementation of the remediation plan will remove the contamination or bring it to a de minimis level, the remedial work must be completed, including clearance testing, and the remediation itself must be approved, including issuance of any clearance and closure documents, by the LSTF authority prior to issuance of the Firm Commitment.
8. Remediation Timing - Definitive Determination of Cost and Effectiveness of Remediation. If the extent of contamination can be definitively determined and the cost of removing that contamination can be specified, HUD may allow a remediation plan that has been approved by the LSTF authority that;
 - a. permits the remediation including site testing, any clearance and closure documents, and the approval by the LSTF, prior to initial endorsement, or
 - b. if the applicant can show cause why it would be impractical to complete remediation prior to initial endorsement, permits the remediation including site testing, any clearance and closure documents, and the approval by the LSTF, prior to both final endorsement and initial occupancy. (See Section 9.4 for remediation costing.)
9. Disclosure protection during the course of remediation activities. All residents living regularly and construction workers regularly on site while remediation is taking place shall be duly informed and protected from contamination. This requirement must be a part of the remediation plan.

D. Remediation Plans – Complete Removal of Contamination

1. General Requirements. Except for those situations where Section 9.3E (Remediation Plans Allowing for Incomplete Removal of Site Contamination) applies, the Lender must submit a remediation plan designed to bring the contamination identified by the special site assessment per 9.3C to de minimis levels, eliminated to the extent necessary to meet the non site-specific LSTF authority standards, with no active or passive remediation still taking place. There also must not be a need for engineering controls, institutional controls, or monitoring wells.

2. All of the requirements for Section 9.3.C must be met.
3. Offsite Contamination, Groundwater Contamination and/or Vapor Intrusion/Encroachment Mitigation. A remediation plan that involves control of off-site contamination per 9.3G and/or vapor intrusion remediation is not permitted under this section but may be allowed under Section 9.3E, “Remediation Plans – Incomplete Removal of Contamination,” below.

E. Remediation Plans – Incomplete Removal of Contamination

1. Justification. If the costs are deemed to be exorbitant and/or the feasibility deemed impractical for remediation of on-site contamination to de minimis levels pursuant to 9.3D above, or if there is known or expected offsite contamination that poses a risk to the project site, the remediation plan may allow for incomplete removal, as described below. Justification for such incomplete removal must be submitted along with the remediation plan. Such justification must include documentation to HUD that shows that the cost of the incomplete removal of contamination, including any life cycle costs for Operation and Maintenance and any applicable Enforcement requirements of LSTF authorities, are sufficiently below the costs of complete contamination removal per 9.3D.
2. All of the requirements for Section 9.3.C must be met.
3. Bases. The corrective action must be a risk based corrective action (RBCA) based on the appropriate combination of:
 - a. The following ASTM Guides and Practices, as amended as determined by the remediator’s environmental investigator:
 - i. E 1689-95 “Standard Guide for developing Conceptual site models for Contaminated Sites”
 - ii. E 1739 – 95, “Standard Guide for Risk-Based Corrective Action Applied at Petroleum Release Sites”
 - iii. E 1943 – 98, “Standard Guide for Remediation of Ground Water by Natural Attenuation at Petroleum Release Sites”
 - iv. E 2081 – 00, “Standard Guide for Risk-Based Corrective Action”

- v. E 2091 – -05, “Standard Guide for Use of Activity and Use Limitations, Including Institutional and Engineering Controls”
 - vi. E 2435 – -05, Standard Guide for Application of Engineering Controls to Facilitate Use or Redevelopment of Chemical-Affected Properties”
 - vii. WK16004—“Draft Standard Guide for Risk-Based Remedy Selection” (when issued)
 - viii. E 2600 - 10 “Standard Guide for Vapor Encroachment Screening on Property Involved in Real Estate Transactions.”
 - ix. For Lead Contaminated Sites. “EPA, Superfund Lead-Contaminated Residential Sites Handbook, 2003”
- b. And/or LSTF regulatory procedures that may be followed in lieu of the ASTM Guides and Practices, as amended as listed in Section 9.3.E.3.a above, when the remediator’s environmental investigator determines their equivalence.
4. LSTF requirements. The RBCA must always meet the requirements instituted by any applicable LSTF regulatory authority.
5. RBCA report(s) requirements The RBCA report(s);
- a. must meet all of the requirements for Section 9.3.C, and
 - b. must discuss how the remediation plan meets with the applicable ASTM Guides and Practices and LSTF regulatory procedures as listed/discussed in Section 9.3.E.3, above.
6. Risk-Based Corrective Action (RBCA). The corrective action must be an RBCA supported by the applicable combination of;
- a. Engineering and Institutional Controls (EC/IC).
 - i. An appropriate mix of engineering controls such as capping and slurry walls, and institutional controls such as protective covenants and access restrictions are required for all RBCAs, and shall follow the guidance in ASTMs E 2435-

05 and E 2091-05 (above). The RBCA must indicate how it met these Guides. Based on the RBCA, such engineering/institutional controls may be required over only limited portions of the site.

- ii. Operations and Maintenance Plan (O&M) Plan. An O & M plan IC with approval by the LSTF authority, and any applicable enforcement required by LSTF authorities pursuant to such discussion in; ASTM Guides, as amended as determined by the remediator's environmental investigator. (NOTE: LSTF regulatory procedures may be followed in lieu of these ASTM Guides, as amended when the re-mediator's environmental professional determines their equivalence.) The applicant must have in place an Operations and Maintenance (O&M) plan for management of all contamination remaining on the site and any controls thereto. If HUD determines that the mortgagor does not have sufficient capacity to manage the O&M plan, the mortgagor must contract an appropriate servicer to do so. (See Section 9.4 for costing.)
- iii. Hard/Soft Cap Engineering Control. A hard cap EC, such as concrete, generally is required if any contamination will remain on the site after final endorsement. Unless the applicant can justify why a lower depth to contamination would be protective of the health and safety of occupants, the depth of any remaining contamination should be greater than:
 - the depth of the foundations of any existing or proposed structures including sumps,
 - any existing or proposed utilities on site, and
 - five feet below the surface.

In certain situations, HUD may allow for a soft cap (e.g. dirt) if other engineering controls such as an impenetrable geotextile fabric are included. Even if engineering controls are not required for such RBCAs, institutional controls are still required.

- iv. Slurry Wall or Equivalent Engineering Control. A slurry wall or equivalent type EC may be required to prevent offsite contamination from migrating onsite or to prevent onsite contamination from migrating onsite or offsite. If the Phase I pursuant to Sections 9.3.A.1.e, and/or Phase II ESA performed pursuant to Section 9.3.D.11.c, determines that the existence or likely existence of off-site contamination presents a risk to the site or the residents of the project, such a slurry wall or equivalent type EC will be required to prevent such known or perceived off-site contamination from migrating onsite. Also, a slurry wall or

equivalent EC may be required to prevent onsite contamination from migrating onsite or offsite.

- v. Monitored Natural Attenuation and Enhanced Passive Remediation (MNA/EPR). MNA/EPR such as by bio-augmentation where no additional active input is required and passive engineering controls such as a slurry wall may be allowed as part of the RBCA. In such cases the LSTF authority must issue a conditional No Further Action Letter or similar approval. Monitoring wells pursuant to the above RBCAs and meeting the requirements of Section 9.3F will be required to monitor the progress of the remediation. When MNA/EPR is part of the RBCA, the remediation may continue beyond initial endorsement provided that the LSTF authority has determined in writing that such undertakings would be present no threat to health, safety or the environment.
 - vi. Vapor Encroachment/Vapor Intrusion Mitigation.. If a VEC, a likely VEC or a VEC cannot be ruled out pursuant to Sections 9.3.A.1.j or 9.3.B.9 above, then mitigation as discussed in ASTM E 2600-10, Section 7.2 is required, unless a VIA has been performed pursuant to LSTF policy and/or procedure (as discussed Section 9.3.B.9, above and in ASTM E 2600-10, Appendix X7.1) and has determined that it is in compliance with such policy, and/or procedure or would be in compliance after instituting mitigation. When remediation goes directly from a Tier 1 screen or a tier 2 screen, such controls shall, where feasible, consist of a poured-on vapor barrier to be used in conjunction with the active and passive venting systems.
 - vii. IC regarding the groundwater contamination, if applicable as described in Section 9.3.E.6.c are/will be put in place
- b. No Further Action Letter (NFA). The LSTF authority must issue an NFA, or similar approval, except that a conditional NFA may be allowed pursuant to MNA/EPR (see Section 9.3.E.6.a.v). The NFA or conditional NFA must be issued pursuant to the time lines stated earlier in this Section 9.3.C. Additionally, the LSTF authority(ies) must indicate that the remediation that has taken place, and in the case of an MNA/EPR will be taking place is protective of health, safety and the environment.
 - c. Groundwater Requirement A site that is/will be otherwise acceptable if contamination that exists or that will exist after completion of remediation, is or will be in the groundwater, if
 - i. Institutional controls regarding the groundwater are/will be put in place, along with an O&M plan, approval by the LSTF authority, and any applicable

enforcement requirements of LSTF authorities. The ICs must prohibit any and all uses of the groundwater, and.

- ii. The highest anticipated levels of groundwater based on high groundwater and/or 100 year flooding events, are below the levels of any construction or potentially anticipated utility work, and.
 - iii. Any vapors from groundwater and/or soils are shown not to present a significant risk pursuant Tiers 1, 2, 3, and/or 4 of ASTM E 2600.
- d. Safety of and Disclosure to Residents and Workers. Any time contamination above de minimis levels is allowed to remain on site after initial occupancy and final closing, all maintenance workers who might perform activities that could compromise the engineering and/or institutional controls, construction workers, and building residents, etc. are to be informed of the general type and extent of contamination and the protective measures that have been taken. It would be up to residents to inform any of their visitors/guests of these conditions.
- e. Hazardous Substance Quantification. If any remediation plan that is a RBCA, identifies hazardous substances listed in 40 CFR 302.4 that will remain on the property after final endorsement, such plan shall determine the quantity of such hazardous substance and whether it exceeds the levels indicated at 40 CFR 373.2(b). (This is a requirement under CERCLA that would apply to HUD at any such time that HUD might own the property or take over its management.)

F. Monitoring Wells, Flushing Wells, or Testing Wells

1. General Requirements. The presence of a testing or monitoring well on the property does not bar the property from consideration for mortgage insurance. If a monitoring well is required or exists to confirm that contaminants have been removed to intended levels or to determine that MNA/EPR is working properly, engineering/institutional controls as described in 9.3D will be required until such time as contaminants are reduced to de minimis levels and a Final No Further Action letter is issued by the LSTF Authority.
2. Monitoring Well Protocols. Monitoring protocols must be specified in the RBCA and monitoring must proceed to the point that indicates that contaminants have been removed to intended levels or that passive MNA/EPR is working properly.
3. Off-site Contamination – Acceptability. If a monitoring well is required or exists to determine if existing or assumed off-site contamination has migrated or might migrate on-site, the site is

generally not acceptable unless associated engineering and institutional controls are put in place pursuant to a RBCA (see 9.3G) or unless the LSTF authority provides a statement that such off-site-site contamination would not present a risk to the health of the project's occupants if it were to migrate on-site.

4. Flushing Wells – Unacceptable. In no case may a final endorsement/initial occupancy take place when a flushing well is in operation or will be required.
5. Testing or Monitoring Wells Ordered by LSTF. A testing or monitoring well may also be placed on the property by order of the LSTF. The well may test or monitor contamination on the site or monitor for contamination from a neighboring site. If a monitoring well would be required or exists solely to monitor the general health of an aquifer used as for water supply or potential water supply, but not in relation to an existing or potential hazardous condition, that fact is not a bar to environmental approval. However, the Lender must notify the HUD office processing the Application for FIRM Commitment if there is any placement of, or order to place, a monitoring or testing well.
6. Non-operating Wells. Non-operating wells are not a barrier to environmental approval, but must be capped over and closed out by the appropriate LSTF authority.

G. Off-site Contamination

If the Phase I and/or Phase II environmental site assessment pursuant to Sections 9.3A and/or B, above, determines that the existence or likely existence of off-site contamination presents a risk to the site or the residents of the project and the sponsor/developer has no management control over the offsite locations of the contamination, the site is not acceptable unless such off-site contamination is subject to a RBCA meeting all of the requirements of Sections 9.3C and E above.

H. Escrow

An escrow account must be set up for the maintenance of any monitoring wells and engineering controls, such as caps or slurry walls. More detailed information on escrow requirements is contained in Section 9.4.

I. Waivers

If a Hub or Program Center or Regional Office intends to waive any of the requirements in this Section 9.3 that are not regulatory in nature, the advice of the Departmental and/or Housing Environmental Officer or one of the Field Office Environmental Officers should be obtained before the waiver is granted. Such advice is not binding on the Hub or Program Center; however, they must nevertheless ensure that such waiver is in compliance with the environmental requirements of 24 CFR 50.3(i).

J. LSTF Approvals and Reviews

Any approvals/reviews by an LSTF authority referenced in this section must be given directly by that authority and may not be given by a third party approved by that authority to act in lieu of the authority. Approvals by local authorities are only acceptable when such authority is by delegation from the State.

K. Unacceptable Sites

A site over a former solid waste landfill/dump and/or Superfund (National Priorities List (NPL) is generally are not acceptable for development unless the hazardous substances, petroleum, and petroleum products are completely removed, the site is delisted, or for an NPL site only, the Federal Agency with management authority over the site gives approval of the site for residential usage.

9.4

Field Personnel Responsibilities in Reviewing Cases Requiring Remediation

A. General Responsibilities

The Department assumes greater risk anytime that a Firm Commitment is issued on a contaminated site. The risk is even greater when a loan is closed on a site where complete removal of contamination is not possible, requiring monitoring possibly with continuous remediation techniques such as MNA/EPR that were previously discussed in Section 9.3.E and F. Therefore it is essential that field personnel exercise great care in the review process to assure that all reasonable measures are taken to mitigate HUD's exposure and by assuring that an accurate determination is made of any remediation costs that are included in the HUD-insured mortgage. Any special site assessment reports, Phase II or Phase III ESAs, should be reviewed so that the extent of the contamination is fully understood. The applicable ASTMs along with a more complete discussion of this issue are contained in 9.3.C. Although the lender is responsible for assuring that environmental remediation contractors are qualified and experienced, field staff must still review references. Field personnel are also strongly encouraged to consult with their environmental officer.

B. Complete Removal of Site Contamination

1. Valuation. Valuation is generally responsible for the review of all environmental documentation and for the preparation of the SFNC and the form HUD 4128. The forms

must be supplemented as needed to document the review and Valuation's conclusions as to the adequacy of the proposed remediation plan.

Any estimates of value or rents should be made as if the project is unaffected by contamination and conditioned on successful removal. The self-contained appraisal report must address any effect of marketability that may be present due to the prior environmental history.

2. **A/E & Cost.** The responsibility for determining if the cost estimate of the remediation plan is reasonable rests with the A/E & Cost staff. A/E & Cost staff should also determine if the contractor submitting the bid for removal is appropriately bonded and qualified to do the job. Cost data for remediation is not as plentiful as with more routine construction tasks. "Environmental Remediation Estimating Methods" might be helpful in some cases and is available through RS Means at <http://www.rsmeans.com>. In addition, the A/E & Cost staff may consult with local environmental remediation professionals about costs for similar work.
3. **Mortgage Credit.** Mortgage Credit shall administer escrow, and performance and bond payment requirements. The amount of escrow or bond shall be based on the estimated cost of the mitigation work from the contractor. The bond should be for at least 150% of the estimated cost, or an escrow may be established for at least the same amount. The manner of how the cash requirements for the escrow or bond is satisfied and the Lender and Mortgage Credits procedures for administering the escrow shall be in accordance with existing instructions in the Office of General Counsel's Closing Guide. Higher escrow or bonding requirements will be necessary if the appraiser and/or the environmental officer determine that there is a greater than average risk that unforeseen problems will arise, resulting in increased cost. This determination should be based on previous experience with similar work and/or research through local environmental remediation contractors about their experience in containing the cost within their stated estimate.

C. Incomplete Removal of Site Contamination

1. **All Disciplines.** All disciplines should follow the guidance from 9.4.B (above) regarding initial removal or mitigation costs.
2. **Valuation.** In addition, Valuation must assure that the form HUD 92264 and narrative appraisal report contain an estimate of the annual expense or an additional amount added to the replacement reserve (ie., the expense is for actual replacement of a component such as a pump), related to any requirement for continuous monitoring and/or mitigation. The basis for the expense or additional replacement reserve will be from a qualified engineer and/or contractor similar to the reserve for replacement requirement, which is based on the

PCNA. The engineer/contractor's estimate should be sufficiently detailed and supported to allow review by the A/E & Cost staff as well as the Valuation staff.

Any effect on marketability, value or rents related to the need for continuous monitoring/mitigation must be quantified and thoroughly discussed in the self-contained appraisal report.

D. Management, Coordination and Communication

The Department assumes greater risk in cases involving environmental mitigation that will occur after initial endorsement especially when mortgage proceeds are used to fund the cost of remediation. Extra attention must be given to the need for frequent communication, preferably with written documentation, between disciplines that are coordinated by team leaders and Hub/Program Center Directors. It is essential that there be no ambiguity in how information is conveyed relating to levels of contamination, cost estimates and the certainty of the effectiveness of mitigation.

9.5

Environmental Report

In addition to the submission requirements discussed in Section 9.3, HUD requires the Lender to provide a narrative Environmental Report along with any available supporting documentation for the project. The Environmental Report may be separate from the Phase I ESA or included within its body, but as a separate subset. This report should cover the relevant topics in the SFNC in the Forms Appendix. It should focus on those environmental issues that might affect the acceptability of the project including any compliance issues with state environmental laws. The Environmental Report must be submitted at pre-application for those lenders using the preapplication process, or at the Application for FIRM Commitment stage for others.

Additionally, the following important environmental issues that should be included, and in some cases, must be included, within the Environmental Report and are discussed below are:

- A. Lead-based Paint (not covered in the Sample Field Notes Checklist (SFNC))
- B. Asbestos (not covered in the SFNC)
- C. Historic Preservation (Item 18 in the SFNC)
- D. Floodplain Management (Item 17 in the SFNC)
- E. Wetlands Protection (Item 22 in the SFNC)
- F. Endangered Species (Item 24a in the SFNC)
- G. Noise Analysis (Item 19 in the SFNC)

- H. Explosive/Flammable Hazards (Item 20 in the SFNC)
- I. Coastal Barrier Resources (Item 16, SFNC)
- J. Coastal Zone Management (Item 10, SFNC)
- K. Sole Source Aquifers (Item 24b of the SFNC)
- L. Airport Clear Zones (Item 21 of the SFNC)
- M. Other Federal or State Laws (Item 24 of the SFNC)
- N. Additional Hazards and Nuisances (covers pipelines, etc.) (Items 27 and 28 of the SFNC)

Also, these important environmental issues that are discussed in more detail below highlight the issues that HUD staff must analyze during their preparation of the Form HUD 4128 and SFNC and provide guidance by which the lender can assist HUD. These brief descriptions are not substitutes for the requirements in the statutes, regulations, Executive Orders, and handbooks. Note that Item 23 “Toxic Chemicals and Radioactive Materials” of both the SFNC the Form HUD 4128 should include the Phase I ESA, discussed in Section 9.3, above.

A. Lead-Based Paint

1. Lead-based paint, which may be present in buildings built prior to 1978, is not a topic that is covered by Form HUD-4128 or the SFNC, but the topic must be addressed by the sponsor’s architect. See Section 5.15.A.3 of the MAP Guide for substantial rehabilitation and Appendix 5C for existing buildings to be refinanced or purchased under Section 223(f).
2. Lead-based paint requirements are applicable to apartments built before 1978, except they do not apply to housing designated exclusively for the elderly or persons with disabilities, unless a child of less than 6 years of age resides or is expected to reside, and they do not apply to 0-bedroom dwelling units. This section is relevant to conversion, substantial rehabilitation, and to refinancing or purchase of apartments under Section 232(f). It is not applicable to rehabilitation, refinancing or purchase of health care facilities
3. All HUD regulations on lead-based paint are found at the HUD regulation found at 24 CFR Part 35 copies of which, along with guidance materials, may be downloaded from <http://www.hud.gov/offices/lead/enforcement/lshr.cfm> or obtained by telephoning 1-800-424-LEAD.
4. Under the regulation there are different requirements for
 - a. Residential properties built before 1960,
 - b. Residential properties built between 1960 and 1977, and
 - c. Residential Properties built before 1978 being converted form commercial or industrial to residential and for properties built before 1978 undergoing substantial rehabilitation.

For residential properties built between 1960 and 1977. The owner must agree to incorporate ongoing lead-based paint maintenance operations and maintenance plans, as specified in the regulation, into routine building operations. For pre-1960 residential properties, a risk

assessment must be conducted to identify lead-based hazards, and any identified hazards must be treated with interim controls prior to final endorsement (or after endorsement using escrowed funds). The terms “risk assessment”, “lead-based paint hazards”, and “interim controls” are explained in the regulation. Also, pre-1960 properties must agree to conduct ongoing lead-based paint maintenance. Furthermore, pre-1960 properties have the option of conducting “standard treatments” defined in the regulation instead of a risk assessment and interim controls. For conversions and major rehabilitations, there must be a lead-based paint inspection to identify all lead-based paint; and all lead-based paint must be abated (i.e., removed, enclosed or encapsulated). Certain notice requirements also pertain to all three types of property.

6. The cost of lead-based paint hazard controls may be included in the proposed mortgage loan with HUD approval.
7. Most rental transactions are also subject to the HUD-EPA lead-based paint disclosure rule at 24 CFR Part 35, Subpart A).

B. Asbestos

1. While many uses of asbestos are technically allowed today, several uses of asbestos have been banned starting in the early 1970s; and many commercial enterprises have stopped installing asbestos products as of the late 1970s. Some of the more common examples of asbestos containing materials include insulation, sprayed on finishes, such as ceilings, vinyl floor tile and the adhesive to fix the tile in place, siding, and roofing.
2. Asbestos is not a topic that is covered by Form HUD-4128 or the SFNC, but for any proposed project site containing structures built before 1978, the topic should be included in the environmental Report and must be addressed by the sponsor’s architect. See Section 5.15.A.3 of the MAP Guide and Appendices 5B and 5C.
3. Therefore, on any building built before 1978, a qualified asbestos inspector must perform a comprehensive building asbestos survey that is based on a thorough inspection to identify the location and condition of asbestos throughout any structures. In those cases where suspect asbestos is found, it would either be assumed to be asbestos or would require confirmatory testing. If the asbestos survey indicates the presence of asbestos or the presence of asbestos is assumed, and if the Application for FIRM Commitment is approved, HUD will condition the approval on an appropriate mix of asbestos abatement and an asbestos Operations and Maintenance (O&M) Plan.
4. If there is asbestos and it is friable or damaged, HUD strongly recommends that it be removed. If asbestos is not friable or damaged, HUD recommends that at a minimum, it be encapsulated which would be incorporated in the O&M plan.

5. The cost of any asbestos abatement activities may be included in the proposed mortgage loan with HUD approval
6. All asbestos abatement shall be done in accordance with EPA requirements for air pollution prevention and OSHA requirements for Worker Protection.

C. Historic Preservation (HUD Form HUD 4128, Part A, No. 18)

1. HUD must follow the procedures implementing the National Historic Preservation Act (16 U.S.C. 470 et seq.) with regulations found at 36 CFR Part 800. All Applications for FIRM Commitment for HUD mortgage insurance, whether new construction, rehabilitation, refinancing or conversion from non-residential to residential property, are considered “federal undertakings” which require HUD to make a determination of no effect, no adverse effect, or adverse effect upon historic properties. This is required regardless of whether the property is on vacant land, is a rehabilitation of an older property, or is located in an historic district. An historic property means any prehistoric or historic district, site, building, structure, or object included in, or eligible for inclusion in, the National Register of Historic Places maintained by the Secretary of the Interior. Also, HUD must consider the area of potential effect (APE), which is often the site boundary, but occasionally the block on which the site is located or the immediate site environs.
2. To assist HUD in making its historic preservation determinations the borrower or Lender should submit a letter to the State Historic Preservation Officer (SHPO) for the state in which the proposal is located. The letter should consist of a narrative explaining the proposal including the front page of HUD Form 92013. The letter also should include a map identifying the site location, the APE, and an opinion as to whether the proposal would have any effect on historic properties. The letter to the SHPO, and the SHPO response, if any must be included in the environmental report. Lenders may obtain from the HUD office the name and address of the State Historic Preservation Officer (SHPO) who has the right to comment on the proposal. Note, that some SHPOs will not respond to applicants but only to Federal agencies. If this is the case, the Lender should contact the Hub or Program Center. This should be done as soon as possible in the development process. The response from the SHPO need not be received by HUD prior to the Application for a Firm Commitment, but must be received by HUD before a commitment is issued.

Note: Some local HUD office may have a Memorandum of Agreement (MOA) with the SHPO and the proposal may be part of a class of actions that do not require submission to the SHPO under the MOA (ie. a rehabilitation of a structure that was built less than 50 years ago).

3. The SHPO is allowed 30 days (from the receipt of sufficient information from HUD) to reply to requests for consultation. If there is no reply within that time, and if there is no reason to

anticipate an objection to the Application for FIRM Commitment, HUD may make a determination of no effect, and a commitment may be issued. Where an undertaking (HUD insurance) affects an historic property or historic district, the result of the consultation may be design change, research and preservation, salvage, or in rare cases, rejection of the Application for FIRM Commitment. Consultation for these procedures may take considerable time before a commitment can be issued.

D. Floodplain Management (Form HUD-4128, Part A, No. 17)

1. Applications for FIRM Commitment for mortgage insurance are subject to regulations regarding floodplain management found at 24 CFR Part 55 implementing Executive Order 11988 (Floodplain Management). The borrower should check the relevant floodplain map from the Federal Emergency Management Agency (FEMA). If any part of the site or integral offsite development is located within the 100-year floodplain according to the applicable FEMA map, this should be discussed with HUD at the pre-application stage.
2. Mortgage insurance shall not be approved for (1) a property, other than a functionally dependent use, located in a floodway, or (2) any critical action located in a coastal high hazard area, or (3) any non-critical action located in a high hazard area, unless the property is a functionally dependent use, or meets the conditions specified in 24 CFR 55.1(b) and (c). The terms “critical use”, “coastal high hazard area”, “floodways”, and “functionally dependent use” are defined in 24 CFR 55.2 24 CFR 55.12 lists categories of proposed actions for which the floodplain management requirements in 24 CFR 55 are not applicable.
3. New construction in mapped 100-year floodplains is strongly discouraged. This flood buffer zone is extended to the 500-year floodplain for proposed rehabilitation, refinancing, or new construction for facilities housing or serving mobility-impaired individuals – a critical use. Sites for new construction, which are in the 100-year floodplain according to the FEMA Flood Insurance Rate Map, Advisory Base Flood Elevation Map, Preliminary FIRM, or any of their official FEMA digitized equivalents, will not be considered for mortgage insurance unless one of the following steps will be taken:
 - a. A Conditional Letter of Map Amendment (CLOMA) or Conditional Letter of Map Revision (CLOMR) has been obtained from FEMA prior to submission of the pre-application or, in the absence of a pre-application, prior to submission of the application for FIRM commitment. In cases where the applicant has a CLOMA or CLOMR, HUD approval for a Firm Commitment will be conditioned on the borrower: meeting the requirements of the CLOMA or CLOMR; obtaining a Final Letter of Map Amendment (FLOMA) or Final Letter of MAP Revision (FLOMR) prior to final endorsement; and, flood insurance on any building during the construction period until the FLOMA or FLOMR is issued; or

- b. If Section 9.5.D.3.a does not apply, the Department must determine if there may be extraordinary circumstances which lead to the conclusion that there are no practicable alternatives to siting the project in the floodplain. If the Department believes that there may be such extraordinary circumstances, then it must conduct an 8-step decision making process which includes publishing two public notices and taking comments, as summarized in 24 CFR 55.20. In such instances, prior to issuing the first public notice, HUD will need detailed information regarding exactly how the property will be altered and improvements designed. This information includes the elevation of the property, the elevation of the floodplain, and location of life support systems. Except in circumstances where it would not be practicable, in order to minimize adverse impacts, the 8-step process shall require as a condition of any project approval that a CLOMA or CLOMR be issued prior to initial endorsement; a FLOMA or FLOMR be issued prior to final endorsement;; and flood insurance be maintained on any building during the construction period until the issuance of the FLOMA or FLOMR. The eight-step process shall be completed before issuance of the Firm Commitment. HUD must develop the two notices but the costs of publication may be borne by the borrower.
 - c. The 8-step process requires that all “critical actions” as defined in 24 CFR 55.2(b)(2), must comply with the requirements of 24 CFR 55.20(e).
4. Conversion projects, those changing a non-residential use to a residential use, are considered the same as “new construction” for floodplain in management.
 5. For purchase or refinancing actions described in 24 CFR 55.12(a)(2) or repair, rehabilitation, modernization or improvement actions described in 24 CFR 55.12(a)(3), an abbreviated process pursuant to 24 CFR 55.12(a) may be used by the Hub or Program Center to determine their acceptability. The Department will evaluate risks and mitigation measures in making its decision. It is HUD policy to discourage these actions if the lowest floor and/or the life support facilities or egress and ingress of the existing building are more than 12 inches below the 100-year floodplain line. See Sections 9.4.D.7 and 9.4.D.8 for additional conditions for issuance of the Firm commitment.
 6. Where a site does not appear to be located in the floodplain on official FEMA maps, but shows evidence of flooding, HUD is not precluded from qualitatively evaluating the acceptability of the site. Lenders will be required to provide extensive data to aid HUD in evaluating floodplain sites.
 7. In addition to processing under paragraphs 3-6 of this section, any building accepted for mortgage insurance that is located within a FEMA mapped floodplain is required to carry flood insurance in the amount of the loan for the term of the loan, subject to available

maximum coverage. At the time of Application for Firm Commitment, the Lender is required to submit a completed Standard Flood Hazard Determination Form, and proof that the mortgagor has a commitment for flood insurance when the new mortgagor acquires the property.

8. All leases (new and renewal) must contain acknowledgements signed by tenants indicating that they have been advised that the property is in a floodplain and flood insurance is available for their personal property. This applies to properties within the 100-year floodplain and to critical actions within the 500-year floodplain.

E. Wetlands Protection (Form HUD-4128, Part A, No. 22)

1. Applications for FIRM Commitment for mortgage insurance on new construction are subject to Executive Order (EO) 11990 "Protection of Wetlands" In general the EO discourages the development or disturbance of wetlands. Proposals impacting wetlands must be reviewed by HUD to determine consistency with HUD wetland protection policy.
2. Wetlands are those identified on the National Wetland Inventory maintained by the U.S. Fish and Wildlife Service. Projects on land listed in the inventory will be considered only after HUD conducts an eight-step decision-making process which is the same as the one used for the flood plains process (See Section 9.4.D). It includes consultation, issuing two public notices and taking public comment. Wetlands under local or state jurisdiction are subject to state or local review as appropriate. The eight-step process is not applicable to state or local requirements.
3. Only in rare cases will rehabilitation, purchase and refinancing proposals involve wetlands impacts.
4. The Lender will be required to provide extensive data to aid HUD in evaluating wetland impacts. The Lender should consult early with the Field Office on any Application for FIRM Commitment with a site impacting wetlands.

F. Endangered Species (Form HUD-4128, Part A, No. 24)

Under Section 7 of the Endangered Species Act, HUD must consult with the U.S. Fish and Wildlife Service or, where applicable with the National Oceanic and Atmospheric Administration, whenever a proposal may affect an endangered or threatened species or its habitat. A required consultation should be assumed for any site within the critical habitat (as defined in 50 CFR Part 226) of a listed species. In areas where impacts on endangered or threatened species are a concern, all appropriate information regarding possible impacts of the project should be provided to HUD

as early as possible. Consultation under Section 7 may result in more stringent conservation measures than would otherwise be imposed. The Hub will advise the Lender where information on endangered species may be obtained.

G. Noise (Form HUD 4128, Part A, No. 19)

1. HUD standards regarding the acceptability of noise impacts on residential property are found at 24 CFR Part 51 Subpart B. For new construction and conversion from nonresidential to residential projects, these standards must be met. Where threshold criteria are met or exceeded, a noise analysis utilizing the methodology in HUD's Noise Guidebook (HUD- 953-CPD) will be performed by HUD as part of HUD's NEPA environmental assessment. The HUD field office should be consulted prior to attempting to design mitigation measures.
2. For rehabilitation and refinancing, noise exposure by itself will not result in the rejection of existing properties for insurance, but will be considered as a marketability factor. For rehabilitation projects, HUD will encourage appropriate noise attenuation measures for inclusion in the alternation.

H. Explosive/Flammable Hazards (Form HUD 4128, Part A, No. 20)

HUD will not insure a property where structures and residents will be exposed to unacceptable risks posed by proximity to explosive or flammable hazards. This means that for new construction projects, and rehabilitation projects where unit density is increased or where there is a conversion from non-residential to residential or where a vacant building is made habitable, there must be an Acceptable Separation Distance (ASD) away from aboveground storage facilities with explosive or flammable material contents and similar industrial facilities. HUD standards regarding proximity to explosive or flammable hazards are found at 24 CFR Part 51 Subpart C. Analysis of sites near or in the vicinity of these types of facilities must be performed by HUD as part of the NEPA environmental assessment in accordance with the HUD guidebook: "Siting of HUD Assisted Projects Near Hazardous Facilities (HUD-1060-CPD)". If a plan is agreed upon with HUD before the invitation letter, these hazards may be mitigated during the construction period, if the work can be done on the subject property. For projects to be refinanced, purchased, and with minor rehabilitation, HUD will qualitatively evaluate the risks associated with proximity to hazardous facilities.

I. Coastal Barriers (Form HUD 4128, Part A, No. 16)

Under the Coastal Barriers Resources Act, as amended, and cited in 24 CFR 50.4(c), HUD is prohibited from insuring a project located within designated coastal barriers of the Atlantic Ocean, Gulf of Mexico, or the Great Lakes. Projects located within coastal barriers designated on

Department of Interior coastal barrier resources maps will not be accepted for processing.

J. Coastal Zone Management (Form HUD 4128, Factor 10, Planning and Findings)

Projects located within a state's coastal management zone must be found consistent with the approved state Coastal Zone Management program. In many states, HUD will require a letter from the State Coastal Zone Management Agency confirming consistency with the approved program. Mortgagees should be aware of the extent of coastal management zones in coastal states and contact the field office early when examining a proposal in a coastal zone.

K. Sole Source Aquifers (Form HUD 4128, Part A, No. 24)

Projects utilizing municipal water and sewer and with appropriate local drainage and runoff approval require no review for sole source aquifers. For other projects, new construction and some rehabilitation projects located within the boundaries of the recharge area of a designated sole source aquifer must be reviewed by EPA for their effect on the sole source aquifer. An aquifer is an underground body of water usually kept in place by rock, gravel, or sand. HUD offices will identify the local, state or Federal agency with maps of sole source aquifers.

L. Runway Clear Zone, Runway Protection Zones, Clear Zone, or Accident Potential Zone (Form HUD-4128, Part A, No. 21)

1. HUD standards regarding the acceptability of property located in Runway Clear Zones (also known as Runway Protection Zones), Clear Zones, and Accident Potential Zones are found at 24 CFR Part 51 Subpart D. An Accidental Potential Zone is an area at military airfields that is beyond the Clear Zone.
2. Construction or major rehabilitation of any property located within a Clear Zone is prohibited. Acquisition, refinance and minor rehabilitation of projects within Clear Zones are allowed with some restrictions. HUD must determine that projects located in Accident Potential Zones are generally consistent with Department of Defense land use compatibility guidelines for Accident Potential Zones.
3. HUD, as part of its environmental review for an existing property, shall advise the Lender who will advise the mortgagor which is purchasing the property that the property is in a Runway Clear Zone, Clear Zone, and what the implications of such a location are. The buyer must sign a statement acknowledging receipt of this information. HUD may reject for mortgage insurance existing property within a Runway Clear Zone or Clear Zone because of the possibility that the property may be acquired at that later date by the airport operator.

M. Other Federal or State Laws (Form HUD 4128, Part A, No. 24)

1. Applications for FIRM Commitment for mortgage insurance are also subject to provisions of other Federal authorities which seldom require action on the part of HUD, including the Wild and Scenic Rivers Act, Farmland Protection Policy Act, and regulations implementing the Clean Air Act. There are State regulations implementing air quality. HUD will advise the Lender if any actions under these or other Federal or State authorities are required.
2. The HUD office will also determine whether or not Executive Order (EO) 12898, Federal Actions to Address Environmental Justice in Minority Populations and Low Income Populations, is applicable to the project. This Executive Order requires that the provision of HUD mortgage insurance to projects not result in disproportionately high and adverse human health or environmental effects on minority populations and low-income populations. When impacts of a project on a minority or low-income population, or siting of a project in an adverse environment raises questions of discrimination, HUD will perform the necessary analysis before determining acceptability of the project, during the pre-application stage. HUD will advise the Lender at the pre-application stage if this is a concern.
3. HUD may require mitigation of a variety of nuisances and hazards on the property which would affect the health and safety of residents and the security of the collateral.

N. Commonly found or Observed Additional Nuisances and Hazards (Form HUD-4128, Part B No. 27 and 28)

1. All parts of any structure must be at least 10 feet from the outer boundary of the easement for any high pressure gas or liquid petroleum transportation pipeline (Form HUD 4128, Part B, No. 28).
2. No structure shall be located within the easement of any overhead high voltage transmission line. In addition, all structures shall be located outside the engineered fall distance of any support structure for high voltage transmission lines, radio antennae, satellite towers, cellular towers, etc. This does not apply to local service electric lines and poles (Form HUD 4128, Part B, No. 28).
3. HUD has additional requirements regarding operating and/or abandoned oil or gas wells, sour gas wells, and slush pits. Additional information may be obtained from the HUD field office (Form HUD 4128, Part B, No. 28).
4. If any part of a site that would appear to be developed on filled ground, HUD may require that all grading be properly controlled to prevent differential earth movement, sliding, erosion,

and/or other occurrences which might damage dwellings, streets or other improvements (Form HUD 4128, Part B, No. 27).

5. Hubs may adopt additional requirements to address unique local concerns, but, if any local requirement is mandated, the Hub must inform the Deputy Assistant Secretary for Multifamily Housing and the HUD headquarters Housing Environmental Clearance Officer of the requirement and its rationale.

CHAPTER 10

SUMMARY OF MAJOR CHANGES IN CHAPTER 10 OF THE MAP GUIDE

Management Analysis

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

There is a major highlights section in the front of the Guide to direct/advise Field Office personnel and MAP Lenders as to the specific changes made to the Guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects) Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 10 revisions in the new release:

- Section 10.2.A.1 was updated to state that the Previous Participant Certification is now being included as an exhibit in the pre-application stage of processing. In addition a mortgagor may now submit the Active Partner Performance System (APPS) Participant Certification page.
- Section 10.2.8 was added to require a Marketing, Leasing, and (if applicable) Relocation Plan
- Section 10.4 was updated to include the online Active Partner Performance System (APPS) certification process.

10.1

Introduction

- A. Management agents that operate HUD-insured multifamily properties play a key role in providing quality affordable housing. This chapter reflects the policy of property owners, management agents, residents and HUD working together over the long term to meet this objective. MAP Lenders play an important role in the analysis of the proposed management program.
- B. While it is the ultimate responsibility of the project owner/mortgagor to select and oversee the management agent of an insured property, the establishment of an effective relationship among HUD, the owner, and the management agent is critical to the success of the development over the life of the mortgage. The relationship is clarified at the Firm Commitment stage, when detailed management documents are submitted with the Firm Commitment application or when there is a change in management.
- C. The Lender will review these documents to determine whether the proposed management agent demonstrates the capability and track record to assure that the development will be managed in a prudent, efficient, and cost-effective manner. The required documents help to demonstrate whether or not the agent:
 - 1. Is eligible for approval and in good standing with HUD.
 - 2. Demonstrates effective management experience and acceptable operating procedures.
 - 3. Demonstrates adequate fidelity bond coverage.
 - 4. Is in compliance with civil rights laws, regulations and requirements.
 - 5. Is able to positively communicate and cooperate with legitimate resident associations.
- D. If the Lender favorably assesses the above items and HUD approves this assessment, then the owner may execute a Management Agreement with the proposed agent. Since the management agent's contract is with the project owner, it is HUD's policy to not unreasonably withhold approval of the management agent, consistent with the Department's responsibility to protect the public interest.

10.2

Exhibits Required for Firm Commitment

- A. Exhibits
 - 1. Active Partner Performance System (APPS) Participant Certification page (participant signature page with submission id number). The Electronic 2530 (E-2530) Previous Participation Certification page may be submitted as early as the pre-application stage of processing. For all principals and affiliates of the management agent, this Certification provides comprehensive information about all HUD-related experience by the management

agent and is reviewed by the HUD Field Office, and at times by the HUD Washington office. This also applies to lessees.

2. HUD 9832, Management Entity Profile for the Agent. This form provides detailed information regarding the organization, operation, and experience of the proposed management agent. The management plan should provide a narrative overview as support to this exhibit and should include any pertinent leasing or management strategies that are not covered in Form HUD-9832.
3. HUD 9839 A, B, or C - Owner's/Management Agent's Certification, as appropriate. In this document, the agent and owner certify that HUD requirements and contract obligations will be complied with, and that an acceptable Management Agreement will be executed. The agent and owner also certify that no payments have been made to the owner in return for awarding the management contract to the agent, and that no such payments will be made in the future.
4. Proposed Staffing to be charged against the Project. Information is required regarding the job-titles, duties, and salaries of all employees to be working for the project. This information is reviewed to determine if the number, salaries, and duties of the proposed staff is reasonable for the size and type of project being proposed. If there is a non-customary situation, or arrangement, resulting in the need for more or less staff than usual, an explanation of this must be provided.
5. Resident Complaints Resolution Procedure. Provide a description of the procedure used by the agent to resolve resident complaints, as well as examples of how the system has been implemented.
6. Management Agreement, if Applicable. Projects with identity-of-interest agents or independent fee agents must execute a Management Agreement. An Agreement is recommended, but not required, for owner-managed projects or projects managed by a project administrator.
7. **Marketing, Leasing, and (if applicable) Relocation Plan.**

All projects which require absorption of units at economic rents to achieve break-even occupancy must submit a detailed marketing and leasing plan and budget that has been reviewed and confirmed by the proposed property management company. The plan must discuss when marketing efforts will begin, when the leasing office and model units will be opened, how the leasing office will be staffed, and the project's marketing and advertising strategy. The plan must address timing of the construction progress schedule with respect to egress and ingress into the project, landscaping, and access to amenities. These items are in addition to those required by the Affirmative Fair Housing Marketing Plan.

For substantial rehabilitation projects involving temporary relocation or displacement of tenants, the plan must address details of timing, funding and management of the relocation process.

8. Additional Information Required by HUD Field Office. It may be necessary to provide the HUD office with additional information so that a supportable determination of approval or disapproval can be made.

The Lender will carefully review the deliverables included in the Firm Commitment application package to determine the acceptability of the proposed management agent. The Management Entity Profile is of particular importance in determining the qualifications of the proposed agent.

The Lender must review the qualifications for the proposed agent to assess the agent's ability to manage the project effectively and in compliance with HUD requirements. The Lender must consider each of the factors below in reviewing an agent's qualifications.

A. Past and Current Management

1. The Lender must review the proposed agent's past experience and current performance with respect to the following performance indicators:
 - a. Billing
 - b. Controlling operating expenses
 - c. Vacancy rates
 - d. Resident turnover
 - e. Rent collection and accounts receivable
 - f. Physical security
 - g. Physical condition and maintenance
 - h. Resident relations
2. If problems are identified with any of these indicators, the Lender must assess whether the agent has adequately improved its procedures to prevent the recurrence of such problems or whether management initiatives by the agent and owner are sufficient to correct the problems and their causes.

B. Ability to Manage Troubled Projects.

If the project the agent will manage has physical, financial or social problems that require special expertise or skills to manage effectively, the Lender must determine whether the agent has the necessary skills and expertise to manage the project and whether the agent's proposed remedies are appropriate. Agents proposed for these projects should have prior experience successfully addressing similar issues.

C. Management Qualifications.

The proposed management agent should have at least one person who establishes the agent's policies and supervises project operations with the following qualifications:

1. A professional designation in housing management from a national organization that provides such accreditation, or
2. A minimum of two years experience in directing and overseeing the management of multifamily projects serving a similar resident clientele.
3. The Lender may accept a proposed agent without the experience requirements listed in this subparagraph if the agent is satisfactorily managing other HUD-insured or subsidized projects.

D. Past Performance with Identity-of-Interest Contractors.

If the agent purchases goods or services from identity-of-interest companies and has previously managed HUD-insured projects, the Lender must assess the agent's past use of such companies

and whether this use resulted in costs to the project that exceed the prices paid in arms-length transactions. The review should especially consider:

1. Goods and services purchased through any “pass-through” arrangements described in item 11(b) of the Management Entity Profile.
 2. Evidence that the agent has compared prices and that the use of any identity-of-interest companies or pass-through arrangements has been more advantageous to the project than purchasing through arms-length transactions would have been.
 3. Evidence that the management agent followed HUD contracting and hiring guidelines.
- E. The Lender can utilize the following additional sources to determine the capability and expertise of the proposed management agent:
1. Management Entity Profile. The Lender can use the information listed on the form to solicit opinions from HUD Offices that have worked with this agent.
 2. Performance Evaluations for the proposed agent and projects which the agent has managed or is currently managing if those projects are under Flexible Subsidy contracts or Workout Agreements.
 3. Monthly and Annual Financial Statements of the Project including the Independent Public Auditor (IPA) Internal Controls Questionnaire.
 4. Additional Documentation. Additional documentation that the Lender may review includes:
 - a. HUD/mortgagee on-site review reports;
 - b. Correspondence;
 - c. Resident complaint files; and
 - d. Previous management reviews.

10.4

HUD Review of the Previous Participation (2530)

- A. The Active Partners Performance System (APPS) was developed to automate the submission and review of the HUD Previous Participation Certification Process (Form 2530). APPS allows for four types of 2530 submissions:
1. Baseline submissions
 2. Property submissions
 3. Organization change submissions
 - a. Major Organization Change
 - b. Corporate buyout
 - c. Court Order/Inheritance
 - (4) Minor organization changes

4. Identity change submissions.
- B. The type of submissions which HUD staff will review and therefore, which APPS will check for derogatory information are:
1. Property submissions – all participants in the applicant’s organization structure will be checked/ reviewed.
 2. Major Organization Change Submissions – all principals in the applicant’s tier as well as all organizations and individuals who are principals in the organization(s) that is being added as a principal to the applicant’s tier will be checked/reviewed.
 3. Corporate Buyout Submissions – the applicant (buyer) and all the principals in the buyer’s organization structure will be checked/ reviewed.
 4. Identity Change Submissions – the applicant will be checked/reviewed.
- D. APPS will check the following data sources for derogatory information on the entities that HUD staff will be reviewing:
1. Government-wide Suspensions and Debarments that APPS downloads from the GSA Excluded Parties List System (EPLS).
 2. Participant Flags that HUD staff entered into APPS.
 3. PPRS/F19 Participant Flags that HUD staff originally entered into that system and which have been converted into APPS.
 4. Previous participation that Industry entered into APPS (with REAC and non-REAC physical inspection ratings).
 5. REAC Physical Inspections.
 6. Participant marks that Headquarters entered into APPPS.
 7. Certifications that the Industry entered into APPS.

10.5

Bonding Requirements for Agents

The Lender must also determine whether the agent has adequate bonding to provide a basic level of protection for the multifamily project assets.

- A. The management agent must certify in the Management Certification that it carries fidelity bond or employee dishonesty coverage for:
1. All principals of the management entity, and
 2. All persons who participate directly or indirectly in the management and maintenance of the project and its assets, accounts, and records.
- B. The fidelity bond or coverage must name the mortgagee and HUD as additional loss payees.

- C. Coverage may be through one or more bonds, and one bond may cover more than one project, including projects whose mortgages are not insured or held by HUD. The agent's principals and supervisory and front-line staff may be covered under the same bond.
- D. Each project must be insured for at least the value of two months' gross potential income for the project. If a bond covers more than one project, this minimum must be computed using the project with the highest gross potential income.

10.6

Management Agreement Requirements

- A. Applicability. Projects with identity-of-interest agents or independent fee agents must execute a Management Agreement. An Agreement is recommended, but not required, for owner-managed projects or projects managed by a project administrator.
- B. Required contents. The owner and agent may negotiate their own form of agreement provided that it contains language to meet the following requirements:
 - 1. Scope of service. All management agreements must describe the services the agent is responsible for performing and for which the agent will be paid management fees.
 - 2. Required clauses. All agreements must provide that:
 - a. Management fees will be computed and paid according to HUD requirements.
 - b. HUD may require the owner to terminate the agreement.
 - (1) Immediately, in the event a default under the Mortgage, Note, Regulatory Agreement, or Subsidy Contract attributable to the management agent occurs;
 - (2) Upon 30 days written notice, for failure to comply with the provisions of the Management Certification or other good cause; or
 - (3) When HUD takes over as Mortgagee in Possession (MIP).
NOTE: As good business practice, the management agreement should always give the owner the ability to terminate the contract for cause, with notice.
 - c. If HUD terminates the agreement, the owner will promptly make arrangements for providing management satisfactory to HUD.
 - d. HUD's rights and requirements will prevail in the event the management agreement conflicts with them.
 - e. The management agent will turn over to the owner all of the project's cash trust accounts, investments, and records immediately, but in no event more than 30 days after the date the management agreement is terminated.
 - 3. Prohibited "hold harmless" clause. Management Agreements cannot exempt the agent from all liability for damages and injuries.

- C. Length/term of the Agreement. The length/term of the Agreement is negotiated between the owner and the management agent. HUD may impose a maximum term on the Management Agreement if the HUD staff approved the agent on a conditional basis.
 - 1. The contract may provide for a fixed term or an open-ended term (e.g., automatically renewable or “to remain in effect until cancelled by HUD, the owner, or the agent”).
 - 2. If the length /term of the Agreement changes, the owner/agent must submit a new Management Certification.

10.7**Approval/Disapproval of Proposed Management Agent**

- A. Generally, the Lender will recommend approval to HUD of the proposed agent as long as the HUD 2530, Previous Participation Certification is approved, the proposed agent has demonstrated capacity to effectively manage the property within HUD requirements, and the management agent has shown adequate fidelity bond coverage. In some instances, the Lender may find it necessary to recommend conditional approval if there are areas of the agent’s procedures that are considered weak or that need to be changed. All conditional approvals will be discussed with the proposed agent and any agreements/conditions settled upon will be shown both in the letter approving the agent, and in HUD’s Firm Commitment.
- B. The Lender will provide a report to HUD regarding its review and recommendation to HUD which includes the following information:
 - 1. Name of the proposed management agent.
 - 2. Composition of the proposed management agent.
 - 3. Narrative of the agent’s experience and capacity to operate the subject property.
 - 4. Demonstration that adequate fidelity bond coverage is in effect and that the proposed management agreement meets HUD’s requirements.
 - 5. The Lender’s recommendation to HUD to approve or disapprove the proposed management agent.
- C. The HUD Office may disapprove a proposed management agent based on the decision of HUD Headquarters’ Participation Control Office/Review Committee’s decision to deny or withhold approval for the proposed agent’s participation. To proceed with Firm Commitment review, the owner must then propose another management agent (and supply all required documentation) or appeal the decision of the Previous Participation Committee under 24 CFR, Part 200.241.
- D. HUD will review the Lender’s report and the management entity profile for the agent (HUD-9832) and make the final determination to accept or reject the proposed management agent.

10.8**Affirmative Fair Housing Marketing**

The Affirmative Fair Housing Marketing Requirements (24 CFR 200.600, Subpart M) apply to all insured multifamily projects of five or more units. Each applicant for the programs addressed in this Guide must

submit an Affirmative Fair Housing Marketing Plan or Form HUD-935.2. The plan must describe an affirmative program to attract tenants regardless of race, color, religion, sex, disability, familial status or national origin to the housing for initial rental. The affirmative advertising program shall use majority and minority media and shall identify those groups within the eligible population that are considered least likely to apply for the housing without special outreach. The plan should also include information on the applicant's nondiscriminatory hiring policy, its training program on nondiscrimination for its rental staff, and the display of the Department's Equal Housing Opportunity logo type and slogan. HUD shall review and approve the Plan prior to the issuance of the Firm Commitment.

Mortgage Insurance under Section 223(f) of the National Housing Act while covered by the nondiscrimination provisions of the Fair Housing Act and Executive Order 11063, is exempt from the submission of a written plan. However, a Section 223(f) applicant is required to conceive, implement and maintain records for its affirmative marketing efforts.

CHAPTER 11

SUMMARY OF MAJOR CHANGES IN CHAPTER 11 OF THE MAP GUIDE

Lender Underwriting HUD Review

This memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

There is a major highlights section in the front of the Guide to direct/advise Field Office personnel and MAP Lenders as to the specific changes made to the Guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 11 revisions in the new release:

- We simply added in Section 11.1.B a signature requirement for the Underwriter's Narrative Summary.
- Section 11.2.B provides HUD appraiser review instructions for data verification and inspections. This section is focusing on the sensitive nature of the information collected in appraisals as it relates to property comparables. Appraisers are required to verify and inspect property comparables and to protect the information they collect.
- Section 11.2.D addresses the procedures the HUD review appraiser should follow according to USPAP Standard 3 when the review appraiser decides to modify the original appraisal because the conclusions differ from the original appraiser's conclusions.
- Section 11.2.G.5 & NOTE addresses the HUD team review of the firm commitment application. Sometimes a more extensive review of the deliverables for a transaction is required when it may appear that FHA could be at risk. In such case the 5-day HUD review can be extended to reach a resolution. We provide four areas plus one new area the Previous Participation Certification review that could cause to extend the HUD review process.

- We expanded Section 11.2.H to state that the Team Leader's underwriting recommendation memorandum will have attached several documents that support the HUD Office's conclusions.

- New Section 11.2.I.2 addresses the firm commitment decision for early start construction and that the Hub Director cannot waive these requirements.

- New Section 11.2.L.8 adds to this waiver Section that early start provisions are found in Chapter 5.

Lender Underwriting HUD Review

11.1

Lender Underwriting

- A. Pre-application. When a Lender is contemplating submitting a pre-application to HUD, the Lender should provide HUD immediately in writing the names and qualifications of the proposed in-house underwriter, contract appraiser, and/or contract market analyst. The review and approval of the lender's principal staff and consultants must be made by the Hub Director and designated MAP staff within the Hub and Program Centers. If a member of the Lender's staff or a contractor has been previously approved by a Hub the Lender is required only to submit the names of the staff or contractor and note the prior approval. HUD will advise the Lender within five business days of any problems with a proposed reviewer. If a Lender is concerned about key aspects of the transaction, competing proposals, or market or environmental issues, the Lender is encouraged to have informal discussions with HUD staff to gain their insights regarding those concerns. The MAP Lender's underwriter must review the developer's materials before submitting a request for HUD field office review and determine that based on the information provided the proposal should be able to meet the requirements of this guide and represents an acceptable risk to the FHA mortgage insurance fund. The pre-application submission to the HUD field office must include a narrative summary prepared by the underwriter which provides:
1. A description of the proposed project and the surrounding area including demand, extent of competition, vacancy rates, market absorption and any other information that would be useful to FHA.
 2. Explanations for any differences between the HUD-92013 application and the market study.
 3. Features of the proposal (e.g., zoning, unusual site conditions, environmental) which may present potential problems.
 4. List of proposed MAP Lender reviewers of the Firm Commitment application, both in-house and third party, and their qualifications.

NOTE: If the proposed loan is a Section 223(f) requiring no pre-application submission, the list of proposed reviewers and qualifications must be submitted to the Hub before the Lender initiates the appraisal or any technical review in order to avoid any problems with the individual reviewers at the Firm stage. Prior informal discussion with HUD staff would be available and encouraged, but not required for a mortgage insurance application pursuant to Section 223(f).

B. Firm Commitment application: The MAP Lender's underwriter must review the in-house and third party reports and determine that the processing of the loan is in accordance with the requirements of this guide and that the proposed loan represents an acceptable risk (replacement cost programs) or is economically sound (value programs). The underwriter must document any changes made to the Lender's technical reports. In the package submitted to HUD, the underwriter must provide a signed narrative analysis describing all relevant aspects of the mortgage transaction containing a discussion of the following list.

1. Characteristics of the proposed mortgage that make it economically sound or an acceptable risk and the reasons why the Lender recommends the loan for mortgage insurance.
2. Any risk factors.
3. Changes in the project from the pre-application stage including changes in sponsorship, proposed mortgagor development team and Lender reviewers.
4. Evaluation of the financial capacity of the principals of the borrower and its ability to repay the loan.
5. Evaluation of the financial and technical capacity of the general contractor to build/rehabilitate the project.
6. Property's financial analysis (profile and trend) (Section 223(f)).
7. Property's physical description (Section 223(f)).
8. History of borrower's equity investment in the property (Section 223(f)).
9. Analysis of market, rents, expenses and estimated rent-up and operating deficit.
10. Adequacy of the proposed Reserve for Replacement (207/223(f)).
11. Documentation of any changes the underwriter made to the appraisal/technical reports with justification.
12. Requests for any waivers of FHA requirements with supporting documentation.
13. Certifications from the individual reviewers. (See Section 11.2M)

C. Lender Due Diligence Certification: With each Firm Commitment package, the MAP Lender submits a letter signed by a person authorized to bind the Lender (See Chapter 2) which certifies that:

1. The Lender has reviewed all in-house and third party forms/reports/reviews.
2. The preparer of the forms/reports/reviews is qualified as required by this guide, and has the insurance, if any required by this guide.
3. The forms/reports/reviews were prepared in the manner required by the guide and the forms/reports reviews are complete and accurate.
4. The proposed loan represents an acceptable risk to the Department (replacement cost programs) or is economically sound (value programs), based upon the Lender's review and analysis and the proposed loan and processing complies with all FHA statutory regulatory and administrative requirements.

D. HUD Forms Submission. The Lender prepares a **Master** HUD 92264 which whenever possible should be signed by the lender's underwriter and all third party contractors. If the third party

contractor has signed the Master HUD 92264, they do not need to prepare an individual HUD 92264. Third party contractors are cautioned not to sign the Master HUD 92264 if they are not in agreement with its conclusions. If the third party contractor is not in agreement with the conclusions in the Master HUD 92264, they must prepare and sign an individual HUD 92264. In all cases, the Lender's underwriter must sign the Master HUD 92264. Any variations between the Master HUD 92264 and the individual contractors' HUD 92264 must be identified and justification for the variance provided.

1. If there is a logistical difficulty in getting all of the technicians' signatures on the Master HUD 92264, it shall be permissible for each third party contractor to complete and sign an individual HUD 92264. All of the individual contractor HUD 92264's must be submitted to HUD along with the Lender's Master HUD 92264.
2. MAP requires the Lender to certify that all parties preparing forms, reports, or reviews are qualified as required by the MAP Guide. HUD does not review qualifications of the mortgagor's Architect as it is the Lender's responsibility to determine that the mortgagor's Architect is qualified. This is also the case for 223(f) projects. HUD does not need to review the Needs Assessor's qualifications. The Lender signs the Master HUD 92264 submitted with the application.
3. Headquarters has mandated the input of tracking data in the Development Application Processing (DAP) system; however its use for processing applications is optional.
 - a. HUD's review procedures have not changed with the initiation of mandatory DAP entry. HUD's technical specialists still review the lenders' submission and provide a recommendation of acceptance, modification, or rejection. If modifications are recommended, the field office makes the determination whether to modify the processing internally or to return it to the lender for modification based upon the scale or severity of the issue. Team leaders recommend whether to approve, reject, or require modification of an application based upon the recommendations of the specialists. Finally, the Hub/PC Director reviews all memoranda and issues the firm commitment, instructs the Team Leader to modify the Firm Commitment, returns the package to the lender for modification, or rejects the application.
 - b. The information ultimately entered into DAP must reflect the final underwriting conclusions that were deemed to be acceptable, and the DAP generated HUD 92264 with the acceptable underwriting conclusions should be attached to the firm commitment. If modifications to the Lender's HUD 92264 were required, it remains the field offices discretion to either modify the HUD 92264 internally or to return the HUD 92264 to the Lender to first complete the modifications before entry into DAP. If a HUD Team Leader or Director chooses to modify the underwriting conclusions that were developed by the HUD technical review team, the technician should be directed to re-open the processing and input the final modified conclusions in the DAP system with a note in the remarks section of the HUD 92264 that the final underwriting conclusions in DAP were modified by the Team Leader or Director and that they differ from those as determined by the technician.

- A. Pre-application. HUD field staff must advise MAP Lenders of competing proposals submitted to the Hub and any market or environmental concerns. If the Team Leader determines that the submitted deliverables are incomplete but curable within a short time, the Lender can have five business days to correct the deficiencies. The Team Leader will advise the Lender by fax or email. Once the Team Leader determines that the pre-application deliverables are complete, the Team Leader assigns the deliverables to the HUD technical specialists including Economic and Market Analysis Staff (EMAS). HUD field staff has five business days for a completeness review of pre-application deliverables. The underwriting review time does not begin until the Team Leader determines the deliverables are complete. The format for the technical specialist review is in Appendices 5, 6, 7, and 8. Upon completion of the technical reviews of the submitted materials, including the list of Lender reviewers and their qualifications, the Team Leader will prepare a memorandum to the Hub director. The memorandum will summarize the results of the technical reviews and recommend whether or not to invite a Firm Commitment application. Where the Team Leader rejects or modifies the recommendation of a technical reviewer, it should be noted in the memorandum. If the Hub/PC Director concludes that an application should be invited, the Team Leader will prepare an invitation letter (See Section 11.2.N) including any conditions. If the Hub/PC Director concludes that an application should not be invited, or there are issues that need to be resolved before an application can be invited, the Team Leader will prepare a letter to the MAP Lender explaining why an application was not invited. If there are issues that need to be resolved or discussed, the Hub has the option of scheduling a meeting with the MAP Lender.
- B. HUD Data Verification and Inspections: HUD appraisers, during the course of their review should:
1. Perform exterior inspections on all properties submitted as comparables.
 2. Verify expense data using the FASS system when FHA insured properties are used as expense comparables. HUD appraisers are not instructed to call owners or management agents to verify the expense data used by the appraiser in his/her report, this information is often sensitive in nature and owners are often reluctant to confirm this information.
 3. Verify a sample of the rent comparable specifics with property representatives or persons knowledgeable of the property.
 4. Insure consistency by making full use of their in-house data sources to verify information from one appraisal to the next. HUD appraisers shall not release any confidential information provided by fee appraisers, and Lenders are also instructed to also protect this information. Exemption of the Freedom of Information Act allows HUD to refuse to release this information so that owners and management agents should be assured that the interests of both the government and the submitters of the information are protected.
- C. HUD Reviews Signature and Certifications: Upon determination of acceptability for processing, the HUD reviewers should sign their individual Technical Reviews and when determined acceptable for processing, the Master HUD-92264 prepared by the Lender. The Master HUD 92264 is the most critical underwriting document because it is a summarization of key technical processing conclusions which, along with the HUD Form 92264-A, are the basis for the FHA Firm Commitment. Since MAP requires a technical review of the Lender's underwriting conclusions,

the Master Form HUD-92264 is the logical and appropriate form that HUD reviewers should sign or co-sign to authenticate their review as opposed to individual 92264s prepared by third party contractors. HUD appraisal reviewers should also sign the Forms HUD-92273 and HUD-92274 that provide crucial underwriting justifications for the amounts in the HUD-92264. Long before the implementation of MAP, it has been an FHA basic procedure to require the HUD review appraiser's signature on the aforementioned forms.

1. HUD technical reviewers, Team Leaders, and Directors should sign the HUD-92264 that is generated by DAP. This is the form that is to be attached to the firm commitment and it is imperative that HUD reviewers sign this version as their final concurrence.
2. If the HUD appraiser has not modified the underwriting conclusions submitted by the fee appraiser, he/she should sign the HUD-92264 as the "Review\Appraiser". If the HUD appraiser has modified the underwriting conclusions submitted by the fee appraiser, s/he then becomes the primary appraiser and should sign the HUD 92264 as the Appraiser.
3. HUD review appraisers should sign the HUD 92264 generated by DAP and should still review and sign the HUD 92273 and HUD 92274 prepared by the fee appraiser as DAP does not complete these forms due to streamlining. If the HUD appraiser recommends changes to the rent or expense conclusions derived by the fee appraiser, the HUD review appraiser must either modify the forms themselves, or return them to the fee appraiser for modification.

The Department believes that the continuation of this long-standing policy clearly documents the underwriting conclusions and decisions made by HUD staff. This same policy is extended to HUD architecture, and cost, and mortgage credit examiners performing review functions under MAP and their respective forms. HUD review appraiser signatures, on such Forms as the 92264, attest to the quality of the review, that the processing is in compliance with MAP technical instructions, that it is free of errors and has no omissions, and that the appropriate appraisal procedures and analysis have been completed. Additionally, as the MAP Guide currently states, MAP requires a Technical Review of appraisals.

The HUD review appraisers' signature on the Master HUD 92264, 92273, and 92274 should not be construed as the reviewers' acceptance of full responsibility for all elements of the report. To avoid any confusion or misunderstanding regarding the HUD review appraiser signing the 92264, 92273 and 92274, the Department invokes the USPAP Jurisdictional Rule. The authority justifying this action should be stated in the review appraisers work product and in Section O, "Remarks and Conclusions", of the HUD Form 92264. As a guide and for the purposes of consistency we suggest that MAP review appraisers use the following language:

"Despite joint signatures of the appraiser and review appraiser on this document, the review appraiser's signature does not constitute the acceptance of full responsibility for the appraisal or the contents of the appraisal report under review. It indicates that the processing has been reviewed in conformance with USPAP Standard 3 and related provisions and found to be acceptable for use in HUD's internal underwriting decision making process".

The HUD's review appraisers' technical review should comply with USPAP Standard 3. To document his review, the review appraiser should complete Appendix 7C.1 and the review report must include a signed certification as prescribed by USPAP Standard 3.

- D. USPAP Standard 3 Concerns for Appraisal Modifications Made By HUD. HUD's review appraisers have the option to modify appraisal conclusions internally or to return the application to the Lender for modification. It is extremely important to note that should HUD's appraiser choose to modify the appraisal value, rent, or expense conclusions internally, as per USPAP Standard 3-1, that opinion becomes it's own appraisal whether it concurs with the opinion of value in the work under review or differs from the opinion of value in the work under review.
1. Per USPAP Standard 3, the reviewers' scope of work in developing their own value conclusions may be different from that of the work under review. The reviewer is not required to replicate the acceptable steps completed by the original appraiser; the items in the work under review that the reviewer concludes to be acceptable can be extended to the reviewer's value development opinion process on the basis of an extraordinary assumption. However, those items not deemed to be creditable must be replaced with information or analysis by the reviewer. These conclusions must be developed in conformance with USPAP Standard 1 and reported in accordance with USPAP Standard 2 on the HUD appraiser's review memorandum.
 2. The reviewer should identify in the Remarks section of the HUD 92264 that the reviewer's conclusions differ from that of the work under review that were submitted with the application.
 3. The HUD appraiser is directed to continue to use the "joint signature" disclaimer identified in the MAP Guide when no modifications have been made to the fee appraisers underwriting conclusions. If the HUD appraiser has modified the fee appraiser's underwriting conclusions, the disclaimer should be modified to note what extraordinary assumptions that the HUD review appraiser has relied upon and what conclusions were developed independently.
- E. Review of MAP Lender Team Members. HUD staff needs to check the Limited Denial of Participation List and the Consolidated List of Suspended and Debarred Contractors. Where the Hub has problems with qualifications or past performance of a Lender reviewer who has prepared the pre-application materials, the Team Leader should halt the HUD review and advise the Lender immediately. In cases where the Lender reviewer will only be involved at the Firm Commitment stage, the field office can make substitution of the reviewer a condition of the invitation letter. For Section 223(f), or where the MAP Lender submits the list of reviewers prior to initiation of Lender processing, the Team Leader needs to request immediate reviews by the technical staff and advise the Lender within 5 days if the Hub has a problem with a particular reviewer.
- F. Environmental Assessment. The MAP Lender can submit any additional or updated environmental information prior to submission of the Firm Commitment deliverables. The Team Leader can direct the staff to complete the HUD environmental assessment prior to submission of the Firm Commitment deliverables in order to expedite the review. The Team Leader should initiate such an action only in instances where it is clear that the MAP Lender will meet the deadline for submission of the Firm Commitment deliverables.
- G. Firm Commitment. If the Team Leader determines that the application is incomplete but curable, the MAP Lender has five business days to correct the deficiencies. Once the Team Leader

determines that the Firm Commitment deliverables submitted by the MAP Lender are complete and acceptable for review, the Team Leader will assign the deliverables to the HUD technical specialists. HUD field staff has five business days for a completeness review of firm application deliverables. (Project fiscal procedures (Handbook 4410.1 REV-2) including selection of project numbers, application and inspection fees, and mortgage insurance premiums, remain in effect.) The Director or Team Leader can require a more extensive FHA review of the deliverables for transactions which may increase FHA's risk such as the following:

1. Mortgage amounts of \$15 million or more.
2. Requests for waivers of commercial space or commercial income limitations.
3. Substantial rehabilitation proposals changing building use from non-residential to residential.
4. Requests for waivers of the limitations on the cost not attributable to dwelling use or where the site value allocated for costs not attributable to dwelling use.
5. Delays experienced in clearing issues related to Previous Participation Certifications (HUD-2530).

NOTE: The number of days provided for the MAP HUD review also gives consideration to the time needed to resolve issues that may develop during the process. Accordingly, HUD's review time is not extended to resolve issues because that is part of the review process. MAP provides the HUD Office a variety of options to conclude its review on time including rejection. HUD's review time may be increased for the specific reasons listed above.

- H. Underwriting Recommendation. Each HUD technical specialist by discipline would review the respective Lenders' reviewer's reports, the underwriting summary and certain key elements of the application specified in the Guide. The HUD technical specialist would review the quality of the Lender's review and the transaction itself. The HUD technical specialists would not reprocess the case. However, if the technical specialist determines that certain underwriting conclusions are not supportable and affect HUD's risk, the specialist would recommend modification of the Firm Commitment application, recommend that the Lender modify the application or recommend a rejection. Whether to modify internally or by the lender may depend upon the scale or severity of the issue, timing, etc. The Team Leader must make the decision to approve, reject or require modification of the application based upon the recommendation of the specialist. The formats for the HUD technical specialist reviews are in the appendices to Chapters 5, 6, 7 and 8. The Team Leader is authorized to approve, reject or modify the recommendation of the specialist.

Upon completion of the technical reviews and the environmental assessment, the Team Leader will prepare a memorandum to the Director summarizing the individual reviews of the specialists, any proposed waivers of FHA underwriting requirements and the Team Leader's overall recommendation. The memorandum will specifically address:

1. The adequacy of the initial operating deficit for any new construction or substantial rehabilitation loans,
2. The adequacy of both the initial deposit and ongoing reserve for replacement and any non-critical repairs to be performed after closing for section 223(f) loans,
3. Any environmental conditions and any other concerns raised by the Lender or HUD staff.

Attached to the memorandum will be the Signature list and Previous Participation Certification from APPS, specific HUD staff reviews, the Lender narrative summary, the Lender's technical reviews and, if recommended for approval, a proposed FHA Firm Commitment with Forms

HUD-92264 and 92264A signed by the HUD reviewers and Team Leader. Where the Team Leader has rejected a conclusion by the reviewer, or has modified any technical recommendation by the MAP Lender or HUD reviewer, documentation and justification must be included in the memorandum.

I. Firm Commitment Decision.

1. Once the Director reviews the memorandum and backup documentation, the Director will issue the Firm Commitment and sign the Form 92264 as prepared by the Team Leader, instruct the Team Leader to modify the Firm Commitment, return the package to the Lender for modification **or** reject the application. If the Director overrides the recommendation of the Team Leader, or modifies any technical recommendation by the Lender or any HUD reviewer, the decision and justification must be documented in the file. MAP Lenders can appeal any rejections/modifications to the Hub Director. Firm Commitments will be issued for a term of 60 days with the Hub Director permitted to grant extensions. The Hub Director must assure that prolonged extensions of commitments do not occur. When the Hub Director determines that extenuating circumstances justify extensions of outstanding commitments, the Hub Director must document that the requested delay is not likely to change significantly the underwriting data on which the commitment was based or to undermine the feasibility of the project due to a change in the market, inflation, or other factors affecting cost.

Note: Only the Hub Director, HUB Operations Director or Program Center Director or persons acting in those positions, are authorized to sign FHA Firm Commitments or endorse FHA Mortgage Notes.

The Department has some flexibility when dealing with the resubmission of rejected applications. In accordance with the fiscal procedures contained in HUD Handbook 4410.1 Rev-2, Project Fiscal Procedures will apply.

2. Early Start of Construction. Construction may not start before initial endorsement and recordation of the insured mortgage, except with the prior approval of the Hub Director. A valid outstanding Firm Commitment is always required. See Chapter 5, Section 5.7 for processing instructions. These requirements cannot be waived (See Section 11.2.L.8).

J. Amended Commitments. An amended commitment bears the same date as the original commitment, followed by the date of the amendment. With this type of change, the effective regulations are those outstanding on the original issue date. Most underwriting changes such as changes in mortgage amount and/or interest rate are honored by amended commitments.

K. Reissued Commitments. A reissued commitment carries only its own date since a mortgagee by accepting a reissued commitment surrenders all rights it had under the original or amended commitment. A re-issuance is required for:

1. Request for reconsideration of an expired or terminated commitment
2. Change in location.
3. Major change in plans and specifications
4. Reprocess to reflect changes in the Mortgage Insurance Premiums.

L. Waivers. The Hub Director can waive any requirements of this guide that are not statutory or regulatory except for the following:

1. Debt coverage ratios for all programs.
2. Loan to value ratios for Section 223(f) loans.
3. Restrictions on elderly meal and service packages that preclude high-end Retirement Service Center type facilities.
4. Three year rule for Section 223(f), as modified for properties constructed or rehabilitated with FHA insured loans and Davis-Bacon wage rates.
5. Application exhibits required for pre-application submissions and Firm Commitment applications for specific programs. Documents required by the Guide text, which may in some cases not be mentioned on the exhibit list, are still submission requirements.
6. Processing stages (Pre-application and Firm Commitment) and HUD review procedures.

a. The Hub Director to the Director of the Office of Multifamily Housing Development should submit all waiver requests requiring Headquarters approval as early as possible. Please note that any requests for regulatory waivers will take Headquarters longer to process since they require review and concurrence from the Office of General Counsel and the Deputy Assistant Secretary for Multifamily Housing as well as the review and approval of the Assistant Secretary for Housing/ FHA Commissioner. Headquarters will not consider waiver requests submitted directly by MAP Lenders.

b. Any waiver granted in connection with the proposed transaction must be documented in the field office docket and Washington docket, along with the Lender's request and field office request. Waivers granted at the Hub level must be submitted, along with supporting documentation, to the Office of Multifamily Housing Development attn: Lender Monitoring Division which will review all waivers requested and granted to determine if changes to this guide or the regulations are necessary.

7. A Hub Director is authorized to waive the limitations on Cost Not Attributable (CNA) in Chapter 6 only in those instances where it can be documented that the project will produce affordable housing through the use of bond financing, tax credits, tax abatement, CDBG, HOME, HOPE VI, or similar local funds.

8. The Early Start of Construction provisions in Chapter 5, Section 5.7.

NOTE: Any waiver of this Guide granted by the Hub Director in connection with the proposed transaction must be documented in the field office docket and Washington docket, along with the Lender's request and field office request. Waivers granted at the Hub level must be submitted, along with supporting documentation, to the Office of Multifamily Housing Development Attention: Lender Qualification and Monitoring Division for post review. Headquarters will review all waivers requested and granted to determine if changes to this guide or the regulations are necessary.

M. Certifications.

I understand that my (appraisal, market study or architectural, cost, mortgage credit, valuation review) will be used by _____ (name of MAP Lender) to document to the U.S. Department of Housing and Urban Development that the MAP Lender's application for FHA multifamily mortgage insurance was prepared and reviewed in accordance with HUD requirements. I certify

that my review was in accordance with the HUD requirements applicable on the date of my review and that I have no financial interest or family relationship with the officers, directors, stockholders, or partners of the Borrower, the general contractor, any subcontractors, the buyer or seller of the proposed property or engage in any business that might present a conflict of interest.

I am employed full time by the MAP Lender (underwriter) or under contract for this specific assignment (appraiser, market analyst, cost architect) and that I have no other side deals, agreements, or financial considerations with the MAP Lender or others in connection with this transaction.

_____ Signature

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than \$10,000 or imprisoned for not more than five years or both.

N. Sample MAP Invitation letter format.

Mr./Ms.

Dear Mr./Ms.:

Subject: MAP Invitation Letter
 No.
 Section
 (Name of Project)
 (City/State)

This is to inform you that our staff has reviewed the pre-application materials for the subject proposal and finds it to be worthy of further consideration should you decide to submit an application for Firm Commitment for mortgage insurance. There is a market for the proposal based upon our review of the appraisal and market study. The site appears acceptable based on our inspection and the information provided.

In the event that you desire to continue with this project and submit an application for Firm Commitment, it is understood that the project will have the following characteristics:

<u>Type of Unit</u>	<u>Sq. Ft.</u>	<u>Number</u>	<u>Monthly Market Rental</u>
Efficiency	_____	_____	_____
One Bedroom	_____	_____	_____
Two Bedroom	_____	_____	_____

Three Bedroom	_____	_____	_____
Four Bedroom	_____	_____	_____
Total	_____	_____	_____

Equipment and Services included in the rent are:

Number of Parking Spaces: Enclosed _____ Open _____
 Estimated Monthly Parking Rental \$ _____
 Residential Accessory Income \$ _____
 Commercial Area _____ sq. ft. Estimated Monthly Rental \$ _____

The operating expense estimate of \$_____ per unit per annum is acceptable. The total for all improvements appears to be within a reasonable range. Attached is the current wage decision for this area. Please contact the Labor Relations staff at _____ for any updates while preparing your Firm Commitment application.

Land value/as-is value will be determined at the Firm Commitment stage. Excess costs resulting from any unusual site conditions identified in the construction cost estimate at the Firm Commitment stage will be deducted from the land value fully improved (with offsite improvements installed). The HUD environmental assessment and HUD previous participation (Form HUD-2530) will not be completed until the Firm Commitment package is submitted to HUD.

It is important to understand that this letter is not to be construed as a commitment on the part of FHA to insure a mortgage for your proposal. It is intended only to establish general agreement on the basic concept, market, rents and expenses for your proposal. If the Firm Commitment application submitted is consistent with the pre-application submission, does not trigger the thresholds for a more extensive review, and no problems arise because of environmental or previous participation issues, HUD should be able to complete its review within the scheduled time. If there are significant changes from the concept agreed to at the pre-application submission, HUD will need more time to complete an extensive review and will not be bound by the scheduled review time and could result in rejection of the Firm Commitment application. Significant changes would include changes in:

- a. Location,
- b. Building type,
- c. Market to be served,
- d. Rents, unit number, unit mix or gross project area great enough to affect market potential (i.e., 5 percent) and/or require a new market study and HUD review.

Therefore, you are invited to submit a Firm Commitment application for mortgage insurance, along with a fee of \$3 per thousand of mortgage amount fee with required MAP Lender deliverables, by (insert date 120 days after the date of the letter). The Lender must advise HUD in writing within 30 days of the date of this letter of invitation whether or not it plans to submit an application for the particular project. If it fails to notify HUD within the time required, the invitation letter expires, and it may be required to repeat the pre-application process.

The application for a Firm Commitment must be submitted within 120 days of the date of the letter of invitation. The Hub or Program Center may authorize up to three 30-day extensions of this 120-day limit, but there is no requirement that the extensions be approved. HUD will review the circumstances reported by the Lender to justify the extension of time. The Lender must certify and HUD must determine that the requested delay beyond 120-days is not likely to change the underwriting data on which the invitation was based or to undermine the feasibility of the project due to a change in the market or other factors determined at pre-application.

In a rare circumstance where there is a justifiable request for an extension of time beyond the approved 90 days, the Hub or Program Center Director must request authorization to approve a further extension from the Director of the Office of Multifamily Development or his/her designee. The authorization request must provide the additional time requested, the Hub or Program Center's recommendation, and the reasons the extension is needed. It may be sent and responded to by e-mail.

Section 221(d)(3) applicants should be aware that HUD Headquarters requires prior approval of the firm commitment processing for all Section 221(d)(3) applications which are also subject to appropriations of credit subsidy.

CHAPTER 12

SUMMARY OF MAJOR CHANGES IN CHAPTER 12 OF THE MAP GUIDE Construction Period

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

There is a major highlights section in front of the Guide to direct/advise Field Office personnel and MAP Lenders as to the specific changes made to the Guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; **4435.01 Construction & Servicing before Final Endorsement**, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects), Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Additionally, all HUD forms used in the underwriting of a multifamily project have OMB approval.

Specific Chapter 12 revisions in the new release:

- Removal of Section 232 instructions.

12.1

Start of Construction

- A. Start of initial construction is the date when contract work commences. It must be diligently pursued without appreciable delay between activities. It includes site clearance and other preparatory site work.
- B. Early start of construction may be authorized in accordance with early start procedures (See Chapter 5, Section 5.7). Where it occurs:
 - 1. A pre-construction conference is required before the start of initial construction;
 - 2. Construction inspections and change orders must be done in accordance with this chapter;
 - 3. Authorization of any insured advances cannot occur until the endorsed instrument is recorded at initial closing.

12.2

Pre-Construction Conference

A pre-construction conference is required for every project and must precede the initial start of construction, including early start of construction. The HUD representative, namely the HUD Inspector, usually conducts the pre-construction conference and should hold it at initial endorsement where feasible, since the major participants are present. The pre-construction conference may be conducted by the HUD Construction Coordinator (or designate), if the HUD Inspector is unable to attend.

- A. Required attendees:
 - 1. Mortgagor's representative;
 - 2. Mortgagor's supervisory Architect;
 - 3. General contractor;
 - 4. Major subcontractor(s);
 - 5. HUD representative;
 - 6. HUD mortgage credit analyst; and
 - 7. Lender's representative.
- B. Supplementary Conditions of the Contract for construction, Form HUD-2554. Address Davis-Bacon wage rates, Federal labor standards and equal employment provisions, including:
 - 1. Contract obligations of the general contractor and all subcontractors, including:

- a. Contractor must certify compliance with Davis-Bacon wage rates with each request for advances.
- b. Davis-Bacon wage rates also apply to a second mortgage backing a governmental equity loan.
2. Statement of sanctions imposed for not complying with the supplemental conditions.
3. Requirement that the applicable Davis-Bacon wage decision and the Form HUD-2554 must be made part of the subcontracts for all tiers.
4. Emphasize the importance of Federal wage payments, prompt certified payroll submissions and proper record keeping. Instruct that a copy of the applicable Davis Bacon wage decision and Form WH-1321, Notice to Employees, must be conspicuously posted on the job site.
5. Indicate who on the HUD labor relations staff will review for labor standards compliance and refer any further inquiries concerning Davis-Bacon wage and reporting requirements to that staff.
6. Give copies of the Equal Opportunity poster to the general contractor and the subcontractor(s) to post conspicuously at the job site.
7. Make available copies of HUD's Contractor's Guide to Davis-Bacon.

C. Contract Administration

1. Explain general contract administration, including responsibilities of the Lender, mortgagor, mortgagor's Architect, general contractor, and HUD representative.
2. Explain the procedures for:
 - a. Change orders;
 - b. Requesting construction document clarifications;
 - c. Reporting and correcting non-compliant work;
 - d. Requesting periodic payments and release of escrows;
 - e. Substantial completion of work or portion thereof;
 - f. Permissions to occupy including management plans and rent rolls.
3. Stress that work changes completed in anticipation of a future change order will be regarded as non-compliant. There will be no insured advances for it or other work dependent on it.
4. Periodic advances. Explain:
 - a. Mortgagor's and general contractor's required preparation of requests, including the field approval and subsequent processing;
 - b. Provisions for submitting surveys, title reports, and other documentation in support of construction advances;
 - c. Requirements for contractor's retainage and its release.
5. Stored materials. Explain procedures to request payment for materials stored onsite, and components stored offsite where applicable. (See Appendices 12B and 12C)

6. Offsite work. Explain procedures to request payment for completed offsite work, the required retainage and its release.
7. Termination of contract(s). Discuss provisions for terminating the construction contract and/or Architect's contract, and the Lender's responsibilities during the construction stage and in the event of a default.

D. Cost Certification

1. Summarize cost certification requirements for the mortgagor and (if applicable) the general contractor, subcontractors, equipment lessors and suppliers, and industrialized housing manufacturers. Where there is a second mortgage backing a Governmental loan, advise that cost certification also applies to the second mortgage.
2. Inform all parties that a pre-cost certification conference will be held when construction is 90 percent complete and that complete instructions will be provided at that point.
3. Stress that:
 - a. Identities of interest that develop or become known after initial closing must be reported to the Lender and to HUD within 5 working days of having such knowledge;
 - b. HUD must give prior approval for all identity of interest subcontractors and apply penalties where this is not done;
 - c. Self-owned equipment must be certified;
 - d. Paper conduits are prohibited.
4. Clarify the 50/75 percent rule. (See Chapter 13, Section 13.15)

12.3

HUD Construction Monitoring

A. Purpose of Inspection.

1. Inspection means the periodic observations made of construction at the site of a multifamily housing project by a HUD representative (inspector) for the purpose of protecting HUD's interests. Inspections are made to evaluate the contractor's and Architect's performance, to obtain construction in accordance with the contract documents, and to report on conformance with prevailing wages and other contract requirements.
2. The instructions for inspection are the same for projects involving the insurance of advances and those to be insured upon completion, except for those variations specifically stated to be applicable to one or the other.

B. Access. At all times, HUD has the right of access to the property and the right to inspect all work performed and materials furnished to complete the project.

C. HUD Construction Manager's/Coordinator's duties. The HUD construction manager (CM) or architectural designee is responsible for the proper performance of all functions relating to inspection, as well as the instruction and supervision of all HUD personnel involved. The CM must

keep informed of the general progress of the work on all projects during the construction stage and guarantee period and be familiar with the problems involved.

1. Assignment. A member of the HUD staff will be assigned as inspector by the CM prior to the date set for the beginning of project construction. The person inspecting the project may be a Design Representative, a Construction Representative, or any other person or group hired by HUD to do the inspections. In this guidebook that person is referred to as an "inspector." The CM selects the inspector on the basis of competency with due regard to the scope of the project and to the type of construction involved. Several projects being constructed concurrently may be handled by one inspector. Only in very unusual circumstances will an inspector be assigned full time to any one project. Upon assignment, the CM issues to the inspector the following:
 - a. Set No. 3 of the contract drawings and specifications. This set becomes the HUD as-built set by the inspector conforming it to the contractor's "Record Set."
 - b. Copy of the construction contract. The required Contract where insured advances are involved is Forms HUD-92442 or 92442A. These forms may or may not be used in insurance upon completion cases, but a construction contract in some form is required and must be furnished to the inspector.
 - (1) Form HUD-92442, Construction Contract-Lump Sum, may be used when there is no identity of interest between the mortgagor and the contractor.
 - (2) Form HUD-92442A, Construction Contract-Cost Plus, may be used in any case, and shall be used when there is an identity of interest between the mortgagor and contractor.
 - c. Owner-Architect Agreement, AIA Document B-181, when an Architect is required to administer the construction contract.
 - d. Contractor's and/or mortgagor's cost breakdown - Schedule of Values, Form HUD-2328 when insured advances are involved.
 - e. Drawings and specifications pertaining to off-site improvements.
 - f. Agreements or contracts providing for off-site construction.
2. Field Supervision. The CM shall keep informed of the general quality of inspections and the performance of inspectors by maintaining close contact with their work through job site visits. A regular routine for supervising field operations should be established and followed. Required and suggested methods of field supervision follow.
 - a. A minimum of two field review inspections shall be made on each project to evaluate the performance of the HUD inspector. Field review inspections shall be recorded on a HUD Representative's Trip Report, Form HUD-95379.
 - b. The HUD inspectors may be accompanied during their rounds. This method is particularly advantageous in training new inspectors.

- c. Construction should be field reviewed where the use of questionable methods of construction, materials, uncorrected non-compliance, or other problems are reported.
 - d. Projects should be field reviewed at construction stages where problems have occurred in that jurisdiction.
 3. Office Review. The CM shall review all Trip Reports, Forms HUD-95379, completed by the HUD inspectors. If the reported conditions indicate the necessity or desirability of field review or other special handling, appropriate action shall be initiated.
 - a. Review should not be restricted to the entries on the report. The absence of significant evaluation comments may, under certain circumstances, indicate desirability of field review.
 - b. The CM should be aware of progress, trends, new or uncorrected non-compliance, unusual conditions, etc., in order to be familiar with the work and to initiate any required corrective action immediately.
 - c. The inspector shall be advised of any unsatisfactory action or detail in the report, or any error in its preparation, so that similar mistakes will not occur in the future.
 4. Training.
 - a. Inspection conferences shall be held when deemed necessary by the CM. The purpose of the conference is to maintain and improve the quality and efficiency of the construction observation function.
 - b. Field and office review of inspections will indicate individual training needs and subjects for discussion at inspection conferences.
 - c. It is essential that new inspectors, staff and fee, be trained in the field as well as in the office.
 5. Construction progress meetings. Prior to the start of construction, the contractor, mortgagor, mortgagor's supervisory Architect and the HUD inspector must be informed by the CM that they are required to attend monthly job meetings. The meetings should be at the job site when monthly request for advances are prepared.
 - a. The owner's representative must be a member of the mortgagor entity, usually a general partner. Nonprofit organizations may be represented by a member of the Board of Directors.
 - b. The HUD Inspector must:
 - (1) Comment to the group on the quality of construction and of the Architect's observations and the contractor's supervision.
 - (2) Comment on all known construction defects and deficiencies (non-compliance) and methods of correction.
 - (3) Explain that changes in the work from the contract documents (non-compliance) must be resolved by approved change order

requests or the work done in accordance with the contract documents.

- (4) Inform parties of HUD policy for holdback of construction advances until non-compliance are corrected.
- (5) Record on Form HUD-95379 the meeting and issues raised. Significant concerns of any party should be presented by memorandum through the CM to the Hub Director.

c. Monthly meetings may also be used to resolve equal opportunity and labor disputes. When such disputes are known, the HUD Labor Relations and Equal Employment officers must be invited to attend.

D. Inspector's Duties. The inspector is the field representative of HUD, not a superintendent for the contractor or "clerk of the works" for the owner or Architect. The inspector, as HUD's agent, must endeavor in a tactful, helpful and courteous manner to obtain construction that conforms to the drawings, specifications, and sound construction practice within the scope of the contract. The inspector is factual and explicit in all statements in reporting and recording significant construction developments when observed.

1. Orientation. Upon assignment to a project, the inspector studies the drawings and specifications and becomes familiar with the conditions at the site. If, during this examination or during construction, any nonconformity with HUD requirements or site conditions not considered in the design is found, they are reported by memorandum through the CM to the Hub Director. The Hub Director will work with the Lender, owner, contractor and other related parties to resolve the noncompliance.
2. Facilities. The contractor must furnish the inspector with enclosed working space that is acceptable to HUD. Adequate, but not elaborate, facilities should be required as soon as actual construction begins at the site. (See the Construction Contract in the MAP Forms Book).
3. Inspections. The inspector shall make at least two job site visits each month. Additional visits may be necessary due to the nature of the project. The frequency of inspection should assure reasonable continuity and recognize the size and character of the project, the speed with which construction is progressing and the quality of work on the project. Visits should be scheduled to observe major construction operations without neglecting lesser operations. Sufficient time must be allotted to each visit to make a complete inspection.
 - a. The major functions during inspection are to: Evaluate the construction supervision of the contractor and contract administration of the Architect; report on occupancy, delays, disputes, and changes; report noncompliance with the contract documents observed by the inspector and/or the supervisory Architect; determine that the amounts requested by the contractor and recommended by the Architect for payment are reasonable; conduct employee wage interviews using Form HUD-11; and report on labor and EEO compliance.
 - b. Each inspection shall be recorded on a HUD Representative's Trip Report, Form HUD-95379.

- c. Reporting requirements. The following documents executed during inspection must be promptly sent to the HUD CM, the project Architect and the Lender's Construction Loan Administrator:
- (1). HUD Representative's Trip Report, Form HUD-95379:
The original goes to the CM, with copies to the Architect and the Lender's Construction Loan Administrator.
 - (2). Contractor's Requisition, Form HUD-92448:
Original to the Lender's Construction Loan Administrator for signature. The Lender sends copies of the signed document to the HUD CM, the Architect, and the HUD inspector.
 - (3). Change Order Form HUD-92437:
Original to the Lender's Construction Loan Administrator for signature. The Lender sends copies of the signed document to the HUD CM, the Architect, and the HUD inspector.
 - (4). Permission(s) to Occupy, Form HUD-92485:
When all required signatures (mortgagor, architect, and contractor, mortgagee, and HUD inspector) are affixed, the document is sent to the HUD CM for approval. Upon signing by the FHA authorized agent, copies are sent to the Lender's Loan Administrator, the Architect, and the HUD inspector.
4. Start of Construction. The inspector will report the date of initial construction start and the date of the start of permanent construction on Form HUD-95379.
- a. The date of the initial construction start, used for recording and reporting purposes, is the "start of construction" as used in connection with labor standards and prevailing wage requirements. This is defined as the beginning of initial site clearance and preparation, provided these activities are pursued diligently and are followed, without appreciable delay, by other construction activities.
 - b. The date recorded as the start of permanent construction, used for the purpose of determining the earning of the inspection fee, will correspond to the first day that permanent on-site building elements were put into place, such as footings and/or foundations, pilings, utility lines, etc.
 - c. While excavation is an integral part of foundation work, it does not constitute a start of permanent construction.
5. Unified Report. At the beginning of construction, the inspector should consult with the HUD Design Representative and the CM in regard to the need for inspection of the project by HUD technical specialists. Any differences of opinion between the inspector and the technical specialist in regard to project construction will be resolved by the CM. The inspector submits a unified inspection report to the Architect and the Lender.
6. Shop Drawings and Other Data. During the construction period, the inspector checks whether shop drawings are being submitted by the contractor for approval of the Architect as required by the AIA General Conditions of the Contract. Upon request by the Architect or the inspector,

- the contractor will keep copies of tests, certifications and any other data required by the contract documents onsite for review.
7. Off-site Fabricated Construction. If off-site fabricated construction components are involved, the CM will determine if there is a need for inspection at the factory to determine acceptability. If the manufacturing facilities are outside of the jurisdiction of the HUD Office and inspection is essential, the CM submits drawings and specifications, which are pertinent, together with a request to the Hub Director to have the inspection made by the HUD Office located near the factory.
 8. Distribution. If an Architect is not required for contract administration, then where these instructions require the HUD inspector to submit findings to the Architect, they are submitted to the contractor.
 9. Work Stoppage. The HUD inspector will report to the CM on Form HUD-95379 any work stoppage unless such stoppage is due to inclement weather or other similar reasons. If known to the inspector, the reason for the work stoppage should be stated and also when resumption of construction is anticipated.
 10. Occupancy. The HUD inspector completes the portion, "FHA Inspection Report," of Form HUD-92485, Permission to Occupy, when submitted. This form is used to request permission to rent or occupy specific living units, commercial or other space. The Form is submitted when the inspector reports safe ingress and egress to the units and/or building, and is evidenced by a certificate of occupancy from the locality. Units and spaces should not be occupied prior to approval by HUD. The Construction Manager (CM)/Coordinator (CC) or a designated MAP staff person in the Program Center signs as Chief Architect. The Hub Director and MAP Coordinator should determine who in the Hub or Program Center approves the permission to occupy.
 - a. Occupancy prior to the execution of Form HUD-92485 will be reported to the Hub Director by written memorandum.
 - b. The inspector will also include on the Form HUD-95379, the number of units occupied prior to approval, as well as the date occupancy took place.
 11. Additional duties. In addition, the inspector:
 - a. Advises the Architect administering the construction contract on HUD requirements.
 - b. Reviews the Architect's job log.
 - c. Reviews copies of the Architect's decisions.
 - d. Reports on project construction progress to the CM on Form HUD-95379.
 - e. Notifies the Architect, and the contractor if an identity of interest exists between the owner and the contractor, as soon as possible if it is determined that there are any essential variations in the cost of the work installed, materials stored and the request for construction advances recommended by the Architect.
 - f. Conducts interviews with an appropriate sampling of the laborers and mechanics engaged. Records interview information. Complete Record of Employee Interview, Form HUD-11, in duplicate, in connection with wage and labor compliance in the construction of the project.

12. Construction record. From the initial construction start through final inspection, the inspector shall be responsible for maintaining a record of construction. The record should also include minutes of the pre-construction conference as well as reports of required guarantee inspections. The inspector shall initiate a record binder when the CM first assigns the project or may elect to expand the project record binder to include inspection reports. All forms, reports, decisions and documents relevant to construction or inspection reporting shall be recorded in the binder in chronological order. The journal shall be on the left side of the binder and forms and documents on the right. The forms and documents listed below shall be included in the Construction Inspection Record Binder, when applicable.
 - a. Drawings and specifications: Sets 1, 2, and 3 referenced in journal though filed elsewhere. (Record the storage location of set 1 and use of 2 and 3)
 - b. Off-site drawings and specifications. (Referenced in journal)
 - c. Construction Contract, Form HUD-92442 or 92442A.
 - d. Owner-Architect Agreement.
 - e. Progress schedule.
 - f. Contractor's and/or Mortgagor's Cost Breakdown, Form HUD-2328.
 - g. HUD Representative's Trip Report, Form HUD-95379.
 - h. Contractor's Requisition, Form HUD-92448.
 - i. Change Orders Form HUD-92437, AIA G710, and Architect's supplemental instruction or equivalent.
 - j. Letters, memoranda, notes, and worksheets.
 - k. Journal of Architectural Actions (if separate binder).
 - l. Surveyor's Report, Form HUD-92457 (final and others, if requested).
 - m. Permission(s) to Occupy, Form HUD-92485.
 - n. Record of established escrow including amounts escrowed a complete list of unfinished construction items, record of call back inspections and recommendations for monies to be released.
 13. Projects insured on completion. The inspector reports the percentage of completion of the project on Form HUD-95379 at the end of each month. This percentage is an approximation for general information and is not used for disbursement.
 14. Off-site inspection. The inspector checks all off-site construction for conformity with the terms of the contract and reports progress of work by percentages on Form HUD-95379. Completion is reported on Form HUD-92464.
- E. Reporting and dealing with serious construction problems. HUD Offices must identify and report to the Hub Director and the HUD Office of Lender Qualification and Monitoring Division all insured multifamily projects under construction or in the guarantee period that has serious construction defects or other serious construction related problems.

NOTE: This information will be used to reply to inquiries, as an "early warning system" to troubled projects, and to determine if assistance to the HUD Office is necessary.

1. The inspector must identify all construction problems that may delay completion or lead to foreclosure or assignment of the mortgage to HUD on Form HUD-95379, HUD Representative's Trip Report.
2. The CM must prepare a referral memorandum to the Hub Director when:
 - a. Work stops for 20 calendar days.
 - b. There are slow or non-payments to the general contractor and/or subcontractors.
 - c. Contractor abandons the job.
 - d. Contractor, owner or Architect changes during construction.
 - e. Correction of any construction deficiency is not started within 30 days of the first notification to the contractor.
 - f. Contractor can't or won't correct any construction defect or latent defect.
3. The referral memorandum must include full details of the construction related problem. Include at least:
 - a. A copy of Form HUD-95379, which identifies the problem.
 - b. The inspector's opinion of the cause and recommendation for correction.
 - c. A report of action by the CM and/or other HUD Office staff.
 - d. A report of actions by the owner, Architect, contractor, mortgagee and bonding company (when appropriate).
 - e. A plan of action by the HUD Office if the mortgage is assigned to HUD during construction or foreclosure is initiated by the Lender.
4. Only the initial report is required unless the Hub Director requests further action or follow-up by the HUD Office.
5. For complete instructions on handling problems before closing, see Appendix 13D.

12.4

Architect's Duties in Administering Construction Contract

The Architect shall:

- A. Provide services in accordance with the Owner-Architect Agreement.
- B. Have no identity of interest with the owner or contractor. An identity of interest is defined in the HUD Amendment to the Construction Contract. (See MAP Forms Book).
- C. Ensure that construction is carried out in accordance with the contract documents.
 1. Restrict materials, products and equipment to those specified.

2. Restrict all deviations to those substantially consistent with the original design concept including form, color, and texture.
 3. When arriving at the net amount due on every requisition, compare the cost of the work and materials with the cost to complete the project. Current and previous payment must relate to the total cost for completion.
 4. Restrict substitution of items of a different design or size from those specified to those that are equivalent in utility (i.e., durability, quality, and ease of maintenance).
 5. Restrict substitution of any material differing in composition or appearance from the one specified to one which is equivalent in its attributes (i.e., character, quality, durability and ease of maintenance).
 6. Keep a log on the site that is readily available to the owner and HUD representatives.
- D. Architect's supplemental instructions. The architect administering the construction contract may issue field orders using AIA Document G710, Architect's Supplemental Instructions, or a similar form.
1. The architect must send a copy of each supplemental instruction to HUD, though prior approval by the Lender and HUD is not required.
 2. Supplemental instructions must not involve a change in contract sum or contract time.
 3. Uses of supplemental instructions.
 - a. Directive to contractor to bring construction into compliance with the contract documents.
 - b. Interpretation or clarification of the contract drawings and specifications.
 - c. Order minor changes in the work, not involving cost.
 - d. Accept specified equivalent.
 - e. Record other "field orders" that are not construction changes.
- E. The Architect administering the construction contract is responsible for reporting in writing the results of periodic visits to the construction site. The Architect's log should provide information regarding assessment of the progress of the work and a record of the actions taken to insure that the work is being accomplished in the best interests of all the parties.
1. The American Institute of Architects (AIA) Document G711, Architect's Field Report, may be used for the log.
 2. A log of each visit should show as a minimum the following:
 - a. Date of inspection.
 - b. HUD project identification and location.
 - c. Time, weather, and temperature range.
 - d. Estimated percent of completion.
 - e. Work in progress and conformance with the contractor's progress schedule.
 - f. Persons present at work.

- g. Observations and items to verify.
- h. Information or action required.
- i. Firm name and signature.

12.5

Architect's Adequacy

The provision for the Architect's administration of the construction contract is covered by the Owner-Architect Agreement and by the General Conditions of the Contract for Construction, AIA Document A201. It is the responsibility of the HUD inspector to determine the adequacy of the Architect's administration. The determination of adequacy will not be based on the number of visits or the length of time spent by the Architect on the job but by construction that complies with the contract documents as a result of the Architect's observation.

- A. Deficient administration. If the Architect does not report all observed non-compliances with contract documents and unacceptable performances by the contractor and exploit all avenues to obtain compliance with the contract, then the Architect's administration of the construction contract will be considered deficient. The Architect will not be responsible for actual construction, construction means, methods, techniques or other related responsibilities of the contractor. However, on the basis of on-site observation as the owner's representative, the Architect must keep the Lender, owner and HUD informed of the progress of the work and endeavor to guard the owner and HUD against defects and deficiencies in the construction.
- B. Reasons for termination of services. Inadequate performance, undue delay, misrepresentation or failure to act on the part of the Architect or the Architect's associates and employees shall be reason for the termination of the Architect's services on the project and may adversely affect the firm's acceptability on future projects.
- C. HUD office actions. The HUD inspector shall bring to the attention of the Architect specific areas in which services are considered deficient. Sufficient time and appropriate assistance shall be given to obtain necessary compliance.
 - 1. When the Architect's performance is first observed as deficient, in addition to the HUD Representative's Trip Report, Form HUD-95379, the inspector shall also prepare a written memorandum to the CM of the deficiency advising of any planned actions or assistance. The memorandum should recommend that future requests for Architectural inspection fees be disallowed until performance improves to an acceptable level.
 - 2. An immediate follow-up by the CM is always required. Conferences with the inspector and the Architect should be arranged and a target date established for the Architect to obtain compliance. The CM shall inform the Hub Director of current problems and of established target dates for corrections. Deficiencies related to misrepresentation, undisclosed identity of interest and known illegal kick-backs should be immediately referred to the HUD Office

Counsel with a copy to the Hub Director. All actions by the HUD Office shall be clearly documented.

- D. Request for contract termination. When compliance with the contract cannot be obtained within thirty (30) days the Hub Director shall request termination of the Architect's contract in accordance with the provisions of the Owner-Architect Agreement. Upon termination, the Architect shall be entitled to only the prescribed portion of the fee determined by the percentage to which construction was completed on the date that the Architect was removed from the project. The Hub Director has full authority to secure acceptable performance.
- E. Contract termination. The owner will hire an independent Architect who is acceptable to all parties to continue the administration of the project construction documents. The HUD inspector does not assume the Architect's responsibility.

12.6

Completion Inspections

- A. Substantial completion. The Architect dates and signs the certification on Form HUD-92485, Permission to Occupy, that part or all the work is sufficiently complete, in accordance with the contract documents, and may be occupied for the use intended.
 - 1. The contractor submits a punch list of items to be completed or corrected to the Architect when the work is ready for occupancy. (See Article 9.8, AIA Document A201.)
 - 2. The Architect inspects, checks the punch list and modifies if necessary, and determines when the work is substantially complete. (Dwelling units containing punch list items will not be accepted for occupancy. However, punch list items in interior common areas and on the exterior do not preclude occupancy.)
 - 3. The HUD inspector verifies on Form HUD-92485 the date when the work is suitable for occupancy.
 - 4. HUD Construction Contract takes precedence over inconsistent provisions in AIA Document A201, General Conditions Article 9.8.
 - a. Certificate of Substantial Completion. AIA Article 9.8 provides for the project Architect to prepare a Certificate of Substantial Completion. This is inconsistent with Article 3.C of the HUD Construction Contract, Form HUD-92442 (Lump Sum) and Form HUD-92442-A (Cost Plus), which provides for the use of Form HUD-92485, Permission to Occupy. Form HUD-92485 contains an Architect's Certificate of Substantial Completion. This Certificate shall be the only Certificate of Substantial Completion that is acceptable to the Department. Note that AIA Document G704, Certificate of Substantial Completion, is inconsistent with the HUD Construction Contract and shall not be accepted or used by the HUD inspector to establish the date of Substantial Completion.

- b. Contractor's Guarantee Period. AIA Article 9.8 contains a provision for the contractor's guarantee period to **commence** on the date of Substantial Completion. This provision is inconsistent with Article 2.B of the HUD Construction Contract, Form HUD-92442 (Lump Sum) and Form HUD-92442-A (Cost Plus), which stipulates that the contractor's guarantee period will commence on the date of Final Completion. Article 2.B of the HUD Construction Contract takes precedence over this inconsistent AIA provision.
- B. Final completion inspection. The Architect and inspector make the final inspection upon written request of the contractor. (Inspection may be made individually.)
1. The Architect determines that all punch list items have been completed unless they are beyond the control of the contractor. (Items of delayed completion)
 2. The inspector prepares the final inspection report on Form HUD-95379. The inspector:
 - a. Reports onsite construction complete though there may be items of delayed completion.
 - b. Lists and describes any items of delayed completion.
 - c. Lists any offsite work and reports percentage of completion for each.
 3. The HUD Construction Manager/Coordinator checks the final inspection report.
 - a. If unacceptable, requires re-inspection. (Report is not considered final.)
 - b. If acceptable, endorses the report as follows:
 - (1) "Construction acceptably completed." (If there are items of delayed completion, add, "subject to escrow of funds to assure completion of listed items of delayed completion.")
 - (2) "All offsite sewer, water, electrical and gas facilities are complete, connected and operable, and safe, adequate, all-weather ingress and egress provided." (If offsite item incomplete, adds, "except as stated at the time of inspection.")
 - (3) CM dates and signs the report.
 - c. CM prepares memorandum for the signature of the Hub Director transmitting the final inspection report.
 - (1) States date of final completion (date of final inspection).
 - (2) Lists incomplete offsite work.
 - (3) Lists items of delayed completion and estimate of cost of completion for each item.

NOTE: Escrow must not be less than 150 percent of the estimate to complete and must not exceed 2 percent of the mortgage. Work must be completed within 12 months of the date of the final HUD inspector's trip report.

- C. Guarantee inspections. A minimum of two inspections are made of all work to discover and require correction of latent defects (defective or nonconforming work not observed during construction) within 1 year of the date of final completion.
1. The HUD CM/Coordinator schedules guarantee inspections.
 - a. First must be within 9 months of final completion and should provide for inspection of the entire project.
 - b. Others may be necessary to assure inspection of seasonal items such as heating and landscaping.
 - c. The last must be not later than the 10th day of the 12th month to check previously reported defects and correction, and discover any additional defects.
 2. The inspector reports each guarantee inspection on Form HUD-95379.
 - a. If work is acceptable, state, "All observable work acceptable at the time of this inspection."
 - b. If unacceptable, list latent defects.
 - (1) Describe each item.
 - (2) Recommend method of correction.
 - (3) Estimate current cost of correction.
 - c. Check any item of delayed completion and list completed and uncompleted items under a separate heading.
 - d. Note any improper maintenance or casualty damage under a separate heading.

12.7

Insurance of Advances and Related Matters

A. General.

Insurance of advances is the process of releasing FHA insured mortgage funds and other funds necessary for the construction, acquisition, and/or refinancing of the project. The following general criteria apply to advancing such funds.

1. All escrowed funds for on-site improvements (with the possible exception of grant/loan proceeds furnished by a government agency or instrumentality or tax credit proceeds) must be disbursed before mortgage proceeds. See Chapter 8, Section 8.10 for instructions on grants/loans and tax credits and Appendix 12A for instructions on the pro-rata disbursement of tax credit proceeds.
2. The amount of construction funds approved and advanced for insurance must be consistent with construction progress approved by the HUD Field Representative.
3. Other mortgageable items must be supported with proper bills and/or receipts before funds can be approved and advanced for insurance.

4. The amount advanced for construction items must be adjusted for a 10 percent holdback of the construction contact amount if the follow conditions are met:
 - a. The Contractor has no identity-of-interest with the owner greater than a 5 percent equity interest,
 - b. If applicable, prior written consent from the surety company must be attached to the request for release, and
 - c. There are no questions regarding the contractor's performance concerning the quality of work, compliance with the contract and any change orders or work in progress.

Assuming these conditions are met, the existing standard of 10% retainage will be required until 50% completion. After that, the requirement will be 5% retainage until 75% completion and 2.5% retainage until the loan reaches final endorsement.

5. The final amount approved for insurance must be supported by certified costs recognized in the cost certification review.
6. The Application for Insurance of Advance of Mortgage Proceeds is done on Form HUD-92403, and is initiated by the mortgagor. The initial and final advances are submitted by the Lender to HUD for review and approval. Interim advances are approved by the Lender, based upon the HUD inspectors' approval of the construction amount. (Approved Contract Administrator signs forms HUD 92403 and HUD 92448 in the Authorization HUD Official Signature block.)
 - a. For the initial and final advances, the HUD Program Center Director signs Forms HUD-92403 and HUD-92448, in the following spaces:
 - (1) Under Authorized HUD Official for Form HUD-92403, and
 - (2) Under Director, Housing Development for Form HUD-92448.
 - b. For the interim advances, the Lender (either the Lender's underwriter or construction loan administrator) signs Forms HUD-92403 and HUD-92448 for HUD, in the same spaces as in 6.a (1) and (2) above.
7. Supporting materials to Form HUD-92403 include supporting bills/receipts and Form HUD-92448, Contractor's Requisition, if requesting construction funds.

B. Lender's role in processing HUD-92403.

1. Completes application indicating:
 - a. Amount requested by mortgagor;
 - b. Approximate disbursement date;
 - c. Amount to be advanced from mortgage proceeds;
 - d. Amount disbursed from mortgagor's front money escrow, if any; and
 - e. Total loan proceeds disbursed including current request.
2. Submits initial and final application to HUD for review and approval.
3. Processes and approves interim advances.

4. Ensures clear title before advancing the approved disbursement.
5. Notifies HUD in writing when clear title does not exist.

C. Stages of Advances.

In cases involving insurance of advances, HUD and the Lender's processing of the advance is divided into the following stages:

1. Initial advance. Refers to the first application and coincides with the initial endorsement of the credit instrument. The initial advance will be reviewed and executed by the HUD mortgage credit analyst. The Lender should submit Form HUD-92403, Application for Insurance of Advance of Mortgage Proceeds, with supporting documentation for HUD approval.
2. Interim advances. Refers to subsequent applications up to completion of the project. Interim advances will be processed and approved by the Lender. Ginnie Mae has approved this method.
3. Next to final advance. Refers to the application for the release of the final 5% of the construction holdback upon receipt of contractor's certification and consent from mortgagor, and surety, if any.

Note: This only applies to non-identity of interest contractors or where the contractor's identity of interest is a project ownership of less than 5 percent.

4. Final advance. Refers to the application for any remaining balance of mortgage proceeds at final endorsement. This advance takes into consideration funds necessary to set up the escrows for "Items of Delayed Completion" and "To Be Paid In Cash Items". The final advance is to be processed by HUD. In addition to the Form HUD-92403, the Lender must submit a copy of Form HUD-92451 Financial Record of Mortgage Loan Transaction, which reflects releases to the various payees during the construction period.

D. Instructions for Approval of Initial/Interim Advances. These instructions can be found in Appendix 13A.

E. Contractor's Monthly Requisition and Related Matters. See Appendix 12B for instructions on completing Contractor's Requisition, Form HUD-92448, and related matters.

F. Next to Final Advance. Requested when construction is acceptably complete, even though there may be items of delayed completion.

1. It may provide for the release of the contractor's holdback provided the conditions in Section 12.15.D have been met. The amount approved for release is based on the cost certification review and HUD-approved amount, and considers items of delayed completion.
2. The balance of the off-site escrow may be released provided:
 - a. The off-site sewer, water, electrical and gas facilities are completely installed and connected; and safe and adequate all weather facilities for ingress and egress are provided.
 - b. All other required off-site construction, if any, is completed.

- c. Otherwise, completion is to be assured by a cash deposit in an amount equal to 150 percent of the HUD estimate of the cost of such off-site construction.

G. Final Advance. The Application for Insurance of the Final Advance requests any remaining balance of mortgage proceeds. Ensure that:

1. The mortgagor's cost certification has been approved and the maximum insurable mortgage amount determined using Form HUD-92580, Maximum Insurable Mortgage. See Chapter 14.
2. Form HUD-92403 is accompanied by a completed Form HUD-92448, with required Contractor's Prevailing Wage Certificate, if the contractor's holdback has not been previously disbursed. Refer to Section 12.15.D for instructions on releasing the contractor's holdback.
3. The sum to be approved for advance is the balance of the mortgage proceeds, based on the maximum insurable mortgage on Form HUD-92580. Refer to Chapter 7 for instructions relative to advance amortization adjustment, if any.
4. Set up the escrow under the provisions of Form HUD-2456, Escrow Deposit Agreement, for items of delayed completion.
5. Form HUD-92023, Request for Final Endorsement of Credit Instrument, or FHA-2453, Commitment to Insure Upon Completion, have been submitted and reviewed.
6. Set up the escrow for the mortgagor's unpaid construction costs under the provisions of Form HUD-92476.1, Escrow Agreement for Unpaid Construction Costs, Repairs or Needs Assessment Repairs. Refer to Chapter 13.

H. Keeping the mortgage in balance.

Overruns in soft cost such as interest, taxes, MIP, and insurance which results due to delays before completion of the project and which are the fault of the general contractor, i.e., poor performances, are funded from the liquidated/actual damages clause in the construction contract. This clause is not intended to penalize the contractor, but to provide a source of funds for the increased soft cost. When the interest allocation is near exhaustion, HUD should be notified immediately. The lender should ask the Architect and the HUD inspector to estimate an expected completion date, and follow the following procedure:

1. When the interest allocation is near exhaustion, ask the Architect and the HUD inspector to estimate an expected completion date.
 - a. Compute the minimum liquidated damages for the period between the completion date specified in the construction contract, as adjusted by approved change orders, and the assumed completion date.
 - b. When the interest allocation has been exhausted, Developer's fee if applicable, or the working capital escrow should be used to keep interest current.
 - c. Transfer the computed liquidated damages amount from column I, Construction, to Column G, Carrying Charges and Financing, on Form HUD-92451.

- (1) Allocate full amount to interest, initially.

- (2) Funds may be used for MIP, taxes, or insurance payments, if requested, after the funds for these line items and nonprofit Developer's fee, if applicable and working capital escrow are exhausted. However, funds transferred from the construction account may be used to cover only the cost of these items attributable to the period in Paragraph 1 above, specified in the construction contract and the assumed completion date.
2. Notify the mortgagor, contractor, HUD and surety, if any, by certified mail of the amount and the reason for the transfer.
3. Require written acknowledgment from HUD and surety, if any, before transferring funds.
4. The amount of transferred funds must be reflected on subsequent Forms HUD-92448 as a decrease to item 7, Sum of Cost Breakdown Items Plus Inventories of Materials.
5. After review of the cost certification documents, if the full amount of transferred funds was not needed to cover the cost of interest, MIP, taxes, and insurance attributable to the period identified, the balance will be transferred back to the construction account.
6. In processing Form HUD-92448, before releasing the general contractor's holdback, make adjustment for the lesser of actual or liquidated damages determined in the cost certification review.
7. This procedure should be invoked only if in consultation with the Hub Director, it is determined that the problems causing the delay will be remedied within the near future.

12.8**Construction Change Orders – General**

- A. General instructions. Construction contract changes (change orders) to the scope of contract work, contract price or contract time must be requested by the mortgagor through the Lender on Form HUD-92437, Request For Construction Changes. Forms must be signed by the mortgagor's Architect, the mortgagor, the general contractor, and the Lender. HUD approves the change order.
 1. HUD review and approval. Each HUD discipline as appropriate, including Architecture, Cost, Appraisal, Mortgage Credit, and the HUD inspector must review and make a recommendation to the HUD construction manager.
 2. Approve change orders only when they are necessary, a betterment, or an equivalent. The following information should appear on the face:
 - a. Classification (necessity, etc.);
 - b. Qualification for payment from the contingency reserve in rehabilitation projects and from the Developer's fee for nonprofit mortgagors;
 - c. Whether change order results from error, omission, or negligence on the part of the Architect, contractor, or mortgagor.
 3. Do not approve any change orders submitted after the final HUD Representative's Trip Report, except where:

- a. The change order pertains to “Items of Delayed Completion,” or
 - b. Written approval is given by Hub Director.
4. Surety Approval must be secured in writing before approving any change or aggregate of changes that increase the contract price 10 percent or more. There is no consent requirement where the project’s assurance of completion is by a cash escrow or letter of credit.
 5. Working capital construction contingency. Half of the working capital escrow requirement for new construction transactions, which is 4% of the mortgage amount, is a two percent (2%) construction contingency. This contingency will be used fund “necessary” approved change orders in new construction transactions. The construction contingency portion of the escrow will be refunded to the developer at final endorsement if not used. Change orders funded from the contingency portion of the working capital escrow will not be considered as the basis for a request for an increased mortgage amount half.

B. Policy.

1. Changes must be accurately reported and accounted for pursuant to U.S. Criminal Code, Section 1010, Title 18, U.S.C.
2. Procedures for changes outlined here are not to be used to alter the intent of contract documents or to lower the quality or value of a project.
3. HUD does not initiate any change but may require them as a condition of approval in connection with a change proposed by the Architect, mortgagor, or contractor.
4. All changes must be approved in writing by the Lender and HUD before they are made.
5. Any change that is made without formal approval, even though tentatively agreed to as technically acceptable, must be recorded by the HUD inspector as a noncompliance. This stands until the Form HUD-92437, Request for Construction Changes - Project Mortgages, is approved, and also affects payment of advances.

C. Change order classification.

1. Necessary changes (HUD Representative should document the reasons) are those that arise from:
 - a. Latent conditions that differ from conditions defined by the construction documents;
 - b. Changes in the applicable codes, ordinances, etc. after:
 - (1). Initial closing for insured advances.
 - (2). Firm Commitment for insurance upon completion.
 - c. The Architect’s errors or omissions.
 - d. Damage to completed construction.
2. Betterment changes are those that are economically justified. They must either:
 - a. Increase net income;
 - b. Reduce long-term project maintenance and/or operating expenses; or
 - c. Otherwise enhance the mortgage security.

3. Equivalent changes are those proposed because:
 - a. Specified item is not readily available and the substitution provides equivalent or better utility, or
 - b. Proposed substitution reduces the contract price but provides equivalent or better utility and performance.
- D. Additive change orders. Do not give any explicit or implied assurance that an increase in the insured mortgage amount will be granted when approving construction changes.
 1. Require the mortgagor, except for “necessary” change orders on substantial rehabilitation projects, to escrow funding with the Lender for any additive change order where HUD first estimates that the aggregated change orders equal or exceed a \$5,000 increase in the construction contract price, and for all subsequent additive change orders. Nonprofit mortgagors may use the Developer’s fee to fund additive change orders.
 - a. Excess mortgage proceeds, if available, may be used to fund the escrow for “necessary” and “betterment” change orders. However, any excess mortgage proceeds used to fund the escrow for contractor estimated costs in excess of HUD estimated costs, or HUD estimated costs in excess of contractor estimated costs, may not be disbursed until final closing.
 - b. Permit Lender to accept a third party letter of credit instead of a cash deposit, subject to the Lender agreeing to provide the cash equivalent, where the letter of credit is not immediately met.
 - c. Recognize the cost of third party paid change orders at cost certification, where there are available mortgage savings.
 2. On substantial rehabilitation projects, approve payment from the established contingency reserve in an amount not to exceed the HUD cost estimate for “necessary” additive change orders. “Betterment” change orders are not eligible for payment from the contingency reserve.
 - a. Require an escrow for any amount that the contractor’s cost estimate exceeds the HUD estimate.
 - b. Authorize use of excess mortgage proceeds, if available, to satisfy the escrow requirement, subject to the disbursement limitations in paragraph 12.8.D.1.a above.
 3. Approve the following forms for mortgagor’s application of funds for completed additive change orders:
 - a. Form HUD-92464, Request for Approval of Advance of Escrow Funds, where an escrow is used. Note: This form must be submitted to HUD for approval.
 - b. Form HUD-92403, Application for Insurance of Advance of Mortgage Proceeds, where a rehabilitation project’s contingency funds or nonprofit’s Developer’s fee or excess mortgage proceeds are used.
- E. Deductive change orders. Where the HUD estimated decrease in contract price for any aggregation of change orders:
 1. Remains less than 2-1/2 percent of the contract price reduce the Contractor’s “Final” Requisition, Form HUD-92448, by the appropriate amount.

2. Equals or exceeds 2-1/2 percent of the contract price and for all subsequent deductive change orders regardless of the amount:
 - a. Reflect the decrease in the Contractor's Requisition, Form HUD-92448, Item (8).
 - b. Reduce the original mortgage amount at cost certification, where required.
- F. Changes that adversely affect income are a basis for change order rejection, except where it is a necessary change order and the situation is unavoidable.
- G. Extension of contract time.
 1. Approve an extension only where:
 - a. The delay was beyond the contractor's control (e.g. strikes, differing site conditions, bad weather exceeding the average for the season, etc.) and is documented or associated with an approved change order,
 - b. The extension request was submitted within the limit provided by the contract and the general conditions for delays beyond the contractor's control, and submitted concurrently with any requested changes in the work, and
 - c. The request is accompanied by a Surety's written consent. There is no consent requirement where the project's assurance of completion is by a cash escrow or letter of credit.
 2. Require funding for the increased cost for overhead, interest, taxes, insurance, MIP, and contractor's general requirements by use of a cash escrow, or excess mortgage proceeds, or nonprofit's Developer's fee, if applicable, or from contingency reserve.
 3. HUD enforces liquidated damages in accordance with the contract.
 4. Required documentation. Within 21 days of the date a construction delay occurs, the contractor must document it with the Architect and include:
 - a. Date of occurrence and number of calendar days it covered.
 - b. Effect on construction progress.
 - c. Cause of the delay. If the cause is of a continuing nature, submit the extension request when the cause ceases, but still record the initial date of occurrence and its effects on construction.
 - d. Extension request must also include written consent of the Surety and conform to AIA Document A201, Article 8.3.
- H. Changes to items of delayed completion. These are the only construction contract changes that the HUD Office can approve after project completion. All others require the Hub Director's consent.
- I. Emergency changes.
 1. The only time a change can be made without prior written approval of the mortgagee and HUD is in emergencies that:
 - a. Endanger life or property; or
 - b. Halt construction.

2. However, even then, the Architect must notify the Lender and HUD and as soon as possible, submit a Form HUD-92437.
- J. Insurance upon completion: Construction Contract Changes, Form HUD-92437, are processed in the same way as Insurance of Advance cases, except as modified below:
1. An escrow is not required for additive change orders. The mortgagor:
 - a. Must be able to provide the additional funds required, and,
 - b. Must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented to HUD for insurance upon completion.
 2. Surety approval is not required for the approval of additive change orders regardless of the percentage of contract increase.
- K. Changes to offsite construction must be requested by letter or other acceptable format. Form HUD-92437 may be used as a general guide, but the actual form must not be used.
- L. Other changes. These changes necessitated by error, omission, or negligence of Architect, owner, or contractor must be so recorded by HUD architectural staff or inspector, on Form HUD-92437.
1. Record the reason for the determination.
 2. Indicate that the cost effect must not be included in the mortgage amount.

12.9**Change Orders – HUD Inspector Instructions**

- A. General procedure. (For specific situations, see the appropriate subject heading)

NOTE: For projects involving insurance upon completion, references here to "contract requirements" or "contract documents" include the conditions and provisions of the commitment if there is no construction contract.

1. Contemplated changes are first discussed among the Architect, contractor, owner, and HUD inspector.
2. HUD inspector makes a preliminary determination of technical acceptability before the change is submitted for approval of the Lender and the HUD Office. (This neither commits HUD to the change, nor relieves the Architect or the contractor of having to submit the Form described below.)
3. All onsite changes to construction documents and requests for time extensions must be submitted for approval on Form HUD-92437, Request for Construction Changes - Project Mortgages.
 - a. Required attachments for physical changes are:
 - (1). Appropriate modifications to the contract drawings and specifications;

- (2). Architect's statement that the change:
 - (a) Conforms to the original intent of the contract drawings and specifications;
 - (b) Is necessary to overcome an impediment to construction, or is an addition desired by the owner.
- (3) Backup documentation for amount(s) requested consisting of itemized quantities and costs.
- b. The form must be signed by the:
 - (1) Mortgagor,
 - (2) Contractor,
 - (3) Architect (if an Owner-Architect Agreement is in effect), and
 - (4) Authorized official for the Lender.
4. All offsite changes must be:
 - a. Requested in a letter or other format acceptable to the field office, but not Form HUD-92437.
 - b. Documented and processed the same as on-site changes.
5. The HUD office must promptly review all requests submitted. (Delays could affect construction or contractor requisitions.)
 - a. Processing should normally take no more than 5 workdays and is directed by the Construction Manager.
 - b. All construction change requests must be reviewed, signed, and dated by the Construction Manager.
6. Voiding changes. If an approved change is not made, it must be nullified by a Form HUD-92437 restoring the drawings and specifications to the status prior to the change request or to a status acceptable to HUD.
7. Unapproved changes. When there are unapproved changes in the construction, the HUD inspector must modify the amount of the contractor's requisition to cover:
 - a. The non-compliance (any change that has not formally been approved on Form HUD-92437) and
 - b. Construction removal that may be required if the unapproved change does not receive approval.

- A. Architectural. Review all requested changes for technical acceptability.
- B. Cost.
 - 1. Construction changes:
 - a. The HUD cost estimator will produce a cost estimate for each construction change request submitted by the mortgagor. Apply current data to accepted or amended change order quantities. Include amounts for general requirements and builder's overhead and profit using the percentage of each from Section G of Form HUD-92264 at Firm review.
 - b. Compare estimate with mortgagor's estimate. If reasonable, use mortgagor's figure, otherwise use HUD estimate.
 - c. Complete cost entries on Form HUD-92437 and forward completed form to HUD mortgage credit examiner and/or the appraiser, if applicable.
 - 2. Approved time extensions:
 - a. Calculate additional general requirements cost due to extension of time.
 - (1) Divide cost of general requirements from contractor's approved Form HUD-2328 by the number of months estimated for construction from Section G of Form HUD-92264 at Firm commitment. Sixty-five percent of this amount is the estimate per month of additional general requirements.
 - (2) Use one quarter of the monthly estimate per week.
 - (3) There is no cost effect for extensions of time for less than one week.
 - b. Complete cost entries on Form HUD-92437 and forward completed form to HUD appraiser and mortgage credit examiner.

12.11**Change Orders – Appraisal and Mortgage Credit Instructions**

- A. Appraisal.
 - 1. The HUD appraisal staff must review all requested changes that may affect marketability, value, income, or maintenance or operating cost; and to identify and explain any estimated increase or decrease in net project income on the reverse of Form HUD-92437.
 - 2. The appraiser must forward a Trial Form HUD-92264 and Trial Form HUD-92264-A reflecting the new data for Mortgage Credit re-determination of the maximum insurable mortgage.
- B. Mortgage credit.
 - 1. Processing.

- a. If the mortgagor's or contractor's estimate for the change order exceeds HUD's estimate, the difference must be escrowed with the Lender. Excess mortgage proceeds, if available, may be used to satisfy this requirement. Conversely, that portion of HUD's estimate which exceeds the mortgagor's or contractor's estimate must be restricted and held until final endorsement to ensure funds to complete the project.
- b. Process the cost and appraisal findings and show the cumulative effect on cost of all approved change items.
- c. Use Sections 12.8.D and 12.8.E for additive and deductive change orders.
- d. Recalculate the maximum insurable mortgage when any approved construction change or changes adversely affect net income, e.g., a change that causes an increase in operating costs.
 - (1) Appraisal completes a Trial Form HUD-92264 with an updated income and expense analysis.
 - (2) Re-determine the maximum insurable mortgage.
 - (3) If the re-determined mortgage is lower than the original mortgage amount, as a condition of approval of the change order, indicate in item 3b of Form HUD-92437 that subsequent Contractor's Requisitions, Form HUD-92448, must be reduced by the greater of:
 - (a) The difference in mortgage amounts;
 - (b) The net increase in costs resulting from acceptable construction changes.
- e. Extensions of time.
 - (1) Architectural and cost technicians are responsible for determining whether the delay was beyond the contractor's control and, if so, the length of the approved time extension.
 - (2) Calculate the cost increase due to the extension:
 - (a) Compute daily rate for interest, taxes and insurance by using estimates in Section G of Form HUD-92264 and multiply these rates by the approved time extension.
 - (b) An additional year of MIP will be required if the approved time extend, when added to the estimated construction term plus the 2 months included in Section G of Form HUD-92264; plus previously approved time extensions.

- (c) Add the additional general requirements, if any, noted by the Cost branch on the change order request.

NOTE: Only Item (c) above amends the construction contract price on Form HUD-92437.

- (3) Determine the source of funds for any increase due to the extension, i.e., cash, excess mortgage proceeds or nonprofit's Developer's fee, or contingency reserve funds.
 - (4) Requests for release of excess mortgage proceeds or contingency reserve funds set aside to fund time extensions are submitted on Form HUD-92403.
 - (5) Releases from a cash deposit are made using Form HUD-92464.
 - (6) These funds may be released only after the account for the soft cost item(s) being requested has been exhausted on Form HUD-92451, Financial Record of Mortgage Loan Transaction.
2. Requests for disbursement of contingency reserve funds and nonprofit's Developer's fee for completed change order items are made on Form HUD-92403. All requests:
- a. Must be accompanied by a certification by the mortgagor's supervisory Architect and the HUD Inspector that all the work covered by the change order has been acceptably completed in accordance with contract documents.
 - b. Must include the mortgagor/borrower's certification relative to payment to the contractor contained on Form HUD-92464, Request for Approval of Advance of Escrow Funds.
 - c. Must include the criminal certification contained on Form HUD-92464 for certifications made in paragraphs a and b above.
 - d. Are subject to a 10 percent holdback.
3. Change orders funded from excess mortgage proceeds. Excess mortgage proceeds may be used to fund either necessary or betterment change orders.
- a. These funds may be used to fund HUD's estimate of increased costs as well as any portion of the contractor's estimate which exceeds the HUD estimate. The portion which exceeds HUD's estimate must be restricted until final endorsement.
 - b. Funds are released in the same manner as contingency reserve funds.
4. Releasing Cash Deposit. The mortgagor submits through the Lender Form HUD-92464 when construction covered by a cash deposit is complete and acceptable to HUD.
- a. The mortgagor's supervisory Architect and the HUD inspector must certify on Form HUD-92464 that all work and materials covered by the change order are satisfactory and consistent with contract drawings.
 - b. If construction costs were paid in full with other than the cash escrow or excess mortgage proceeds before submitting the disbursement request to HUD for approval, the mortgagor must submit a receipt of payment signed by the general contractor.

- c. If construction costs will be paid after HUD's approval for the release of the funds deposited for the construction change, before the next Form HUD-92403 is submitted, the mortgagor must submit a receipt of payment signed by the general contractor.
5. Change Order Summary Sheet showing cumulative cost of all executed change orders should contain, at least:
 - a. The date the change order was signed by the mortgagor;
 - b. The date HUD received the change order;
 - c. The date the Mortgage Credit branch processed the change order;
 - d. The mortgagor's or contractor's estimate of cost for the change order;
 - e. HUD's estimate of cost for the change order;
 - f. The amount of change orders to be funded from contingency reserve, nonprofit's Developer's fee, or excess mortgage proceeds;
 - g. The required cash escrow deposit, if any;
 - h. The HUD percentage of cost increase or decrease.

12.12**Labor and Fair Housing and Equal Opportunity (FHEO)****A. Wages**

1. Payrolls. Contractor payrolls are submitted directly to the HUD Labor Relations staff a minimum of once a month.
2. On-site interviews. The HUD Construction Manager forwards all original copies of Form HUD-11, Record of Employee Interview, which are submitted by the HUD inspector, to the HUD Labor Relations Staff.

B. Labor violations. Advise the Labor Relations Staff of continuing minor infractions that cannot be resolved or of any identified or suspected major violations.**C. FHEO violations. Advise the HUD Director of FHEO of continuing minor violations that cannot be resolved or of any identified or suspected major violations.****12.13****Surveys**

Surveys must be by a licensed surveyor and show the exact location of on-site improvements, including utility lines and easements.

A. The contractor must give the owner and HUD surveys:

1. At any time the owner or HUD requires, and
2. When construction is complete ("as-built" survey).

- B. The inspector, when uncertain of the location of construction or stored materials in relation to property lines or easements, may ask the Architect to require a survey with the next contractor's requisition.
- C. If encroachments are found, the inspector must notify the HUD Construction Manager by memorandum explaining the conditions. (Encroachments may jeopardize the entire property as security for an insured mortgage.)

12.14**Permission to Occupy**

Permission to Occupy Form HUD-92485 must be executed by HUD before the mortgagor permits occupancy of any dwelling unit.

- A. Physical completion. The Work or portion thereof for which Permission to Occupy is approved must be sufficiently completed in accordance with the contract documents so the mortgagor can occupy or utilize the identified portion of the work for its intended use.
 - 1. Support facilities (utilities, disability access, vehicular access and parking, fire life-safety equipment, etc.) must be in place.
 - 2. Acceptability of each unit and facility for which Permission to Occupy is requested must be established:
 - a. Property must be inspected and Form HUD-92485 signed by the mortgagor, supervisory Architect, contractor, and HUD Representative.
 - b. Minor items that do not preclude occupancy are permitted but must be listed as an attachment to Form HUD-92485.
 - c. The contractor is fully responsible for any incomplete or improperly performed contract work whether or not listed.
- B. Signatures, Approval, and Permission:
 - 1. Form HUD-92485 is signed by the mortgagor, supervisory Architect, contractor, and HUD representative.
 - 2. Approval: The Construction Coordinator or a designated MAP staff person in the Program Center signs as Chief, Architecture and Engineering Section. The MAP Team Leader signs as Chief Underwriter.
 - 3. Permission to Occupy: The Hub Director and MAP Coordinator will designate an FHA Authorized Agent in the Hub or Program Center to sign the Permission to Occupy.
- C. Submission Documents. The Lender must sign Form HUD-92485 agreeing with the request and stating that insurance risks have been covered for the project. The mortgagor must include the following documents with the completed Form HUD-92485:

1. A Certificate of Occupancy or equivalent permit from the governing municipal authority for all units and facilities listed on the Permission to Occupy; and any other required permits or authorizations;
 2. A certificate of property insurance from the mortgagor's insurance company.
- D. Partial Occupancy Approval.
1. Favorably consider partial occupancy of units as they become available, where vandalism could be minimized, needed project income is provided, an earlier rent-up date could be achieved, utility costs for occupied units can be metered separately from contractor's utilities, etc.
 2. Approve a series of Permissions to Occupy as units or facilities become available, e.g. individual buildings on multi-building projects, or individual floors or wings on larger buildings.
 3. Approve a single Permission to Occupy for all units where dictated by management considerations, e.g. very small projects.

12.15**Escrowed Funds, Letters of Credit, Deposits, Holdbacks and Related Matters****A. Mortgagor's Application for Escrowed Funds.**

Form HUD-92464, Request for Approval of Advance of Escrow Funds, must be used where the escrow is to ensure completion of offsite improvements, additive change orders, non-critical repairs (under the Section 223(f) program), or mortgagor's unpaid construction items at final endorsement.

1. The mortgagor initiates and forwards Form HUD-92464 to the Lender for its review before submitting the disbursement request to HUD for approval.
2. Require the HUD inspector to reflect the percentage of acceptably completed escrow work on the HUD Representative's Trip Report, Form HUD-95379, and forward a copy after review to the Lender for use in reviewing Form HUD-92464.
3. Do not authorize advances in excess of the documented percentage completed, less previous payments and a 10 percent retainage.
4. Where excess mortgage proceeds are used to fund an escrow for completion of offsite improvements, additive change orders, or mortgagor's unpaid construction items, return the original copy of Form HUD-92464 to the depositor, and retain one copy.

B. Release of letters of credit. In the event of a claim:

1. Assignment. HUD will not accept an assignment of the letter of credit to HUD from the Lender.
2. Un-drawn Balance. HUD will treat any un-drawn balance from a letter of credit or escrow agreement as cash held by the Lender.
3. Cash equivalent. The Lender is required to provide cash equal to the un-drawn balance, if demand on a letter of credit is not met.

- C. Working Capital Deposit is established with the Lender at initial closing. It may be funded by cash, letter of credit or excess mortgage proceeds, if any.
1. Purpose. The deposit is used to:
 - a. Defray cost of initial marketing and rent-up. This includes: sales and advertising, model furnishing, and equipment and supplies essential to initial rent-up, etc.
 - b. Set up accruals for items due during the first operating year that project income is not expected to cover, including real estate taxes, permanent property insurance premiums, mortgage insurance premium, ground rents and assessments.
 - c. Cover shortfalls in interest, taxes, property insurance premiums, mortgage insurance premiums, ground rents and assessments during construction after funds available under the Building Loan Agreement are exhausted.
 - d. May be allocated to the reserves for replacement for a project with low income housing tax credits, where acceptable to the mortgagor and HUD.
 2. Control and Release of Escrow. The Lender controls disbursements from the escrow, except where the mortgagor certifies at firm commitment that any balance of the escrow will be applied to the reserve for replacements on a Low Income Housing Tax Credit (LIHTC) or Historic Tax Credit project. In reviewing a mortgagor's request for release of part of the escrow, consider the following:
 - a. Mortgagor's request for the release of such escrow funds must be by letter to the Lender, rather than on Form HUD-92403.
 - b. None of the escrow can be used to defray any of the hard costs of construction applicable to the Total for All Improvements, Section G of Form HUD-92264, Rental Housing Project Income Analysis and Appraisal (or other Firm Stage underwriting form applicable to the Section of Act the project is to be insured under).
 - c. Avoid premature disbursements and unnecessary expenditures.
 - d. As portions of a project are ready for occupancy, a partial disbursement may be permitted for reasonable opening expenses: however, it must be determined that the escrow is not exhausted before the entire project is complete.
 - e. An unsolicited recommendation may be offered by the Field Office that the deposit be used to cover any shortfall in interest, taxes, property insurance mortgage insurance premiums, ground rent and assessments.
 - f. Fully document all expenditures from the escrow.
 3. Final Release of Escrow.
 - a. The Lender may release any balance of the working capital escrow to the mortgagor one year after final endorsement where the project is not in default or when the project has demonstrated to the HUD field office's satisfaction that the project has achieved 6 months of break-even occupancy.

- b. The Lender is advised to hold this escrow until any financial problems are resolved (e.g., has not reached sustaining occupancy, has poor liquidity or high payables, is operating at a deficit or is near default).
 - c. If the project mortgage is in default, the Lender should use any balance of the working capital escrow to cure a default, where a default occurs before its release.
- D. Release of contractor's 10 percent holdback. The holdback provides an incentive for the general contractor and mortgagor to: promptly complete the project, submit cost certification and reach final closing.
- 1. Amount of holdback. The Building Loan Agreement requires the Lender to retain at least 10 percent of the construction proceeds from each advance. The construction contract also provides for 10 percent holdback from the contractor's monthly payments for acceptably completed work, acceptably stored materials, and where applicable, components acceptably stored offsite.
 - 2. Identity of interest contractor. Except as provided in paragraphs 4 and 5 below, do not release any part of the holdback until final closing for a contractor with an identity of interest.
 - 3. Nonidentity of interest contractor. Release the contractor's holdback or remaining balance at the next to last advance, where requisitioned on Form HUD 92403, Application for Insurance of Advance of Mortgage Proceeds, and subject to compliance with the following:
 - a. Contractor's cost certification, where required, has been reviewed and necessary adjustments made to Form HUD-92451, Financial Record and Mortgage Loan Transaction;
 - b. Contractor has disclosed its final obligations on Form HUD-92023, Request for Final Endorsement of the Credit Instrument;
 - c. All work under the construction contract has been inspected and approved by the controlling jurisdictions and/or authorities;
 - d. Certificates of occupancy or other required approvals for the dwelling units, and non-dwelling facilities, where applicable, have been issued by governmental authorities having jurisdiction. Separate buildings for community rooms, rental offices, laundry rooms, etc., commonly require certificates of occupancy;
 - e. Permission To Occupy, Form HUD-92485 has been issued by HUD for all units;
 - f. All Davis-Bacon payroll requirements have been satisfied;
 - g. Surveyor's Certificate, Form HUD-92457, and survey showing the location of all improvements, utility easements and site utility distribution lines have been submitted to HUD, and
 - h. Retain, where applicable, an adequate amount for the following:
 - (1) Items of delayed completion in an amount equal to 150 percent of the HUD representative's cost estimate for completion,
 - (2) Any owed or contested amounts indicated by mechanics, subcontractor, supplier, or equipment lessor liens, etc.

- (3) Lesser of the liquidated damages or actual damages computed at cost certification, and
 - (4) Net effect of negative change orders.
 4. Early partial release of holdback.
 - a. After 90 percent contract completion, the Hub Director may release part of the contractor's holdback and suspend further withholding of holdback from payments due, where:
 - (1) The contractor has no identity of interest or the contractor's only identity of interest is a project ownership of less than 5 percent;
 - (2) The contractor, mortgagor and mortgagee request the early release of the holdback and attach the request to Form HUD 92403, Application for Insurance of Advance of Mortgage Proceeds; and
 - (3) Prior written consent from surety, if any, for the early release of holdback is provided with the request.
 - b. The Hub Director determines that:
 - (1) The contractor's general performance warrants partial release of the holdback without conditions, or
 - (2) Partial release of the holdback with conditions, e.g., measures to assure immediate distributions to subcontractors or others, would be in the mutual interest of all participants, and
 - c. The un-disbursed holdback must equal or exceed 5 percent of the contract amount.
 5. Projects in difficulty. Release of part of the contractor's holdback before 90 percent contract completion may be granted only to prevent a default of the construction loan and only if it would solve the project's problems and enable it to reach construction completion.
 - a. Consider the contractor's performance including:
 - (1) The completed work must be satisfactory,
 - (2) The percentage of completed contract work must be sufficient to ensure project completion within the specified contract time, and
 - (3) Do not release any holdback if there are serious, unresolved questions concerning:
 - (a) Quality of work,
 - (b) Compliance with the contract, including outstanding change orders, or

- (c) Work is progressing behind the contractor's construction schedule, as amended by approved change orders.
- b. Require a written consent for the early release of holdback from the surety, if any, the mortgagor and mortgagee.

12.16**Insurance Upon Completion**

- A. Basic requirements during construction stage are generally the same as for projects with insured advances. However, because HUD does not insure advances for the construction loan, HUD does not monitor the Lender's disbursements. Additionally, because HUD has no risk exposure until final closing, HUD does not become involved in the workout of construction problems. The following are major variations for insurance upon completion projects.
- B. Firm Commitment to Insure upon Completion, Forms FHA-2453, FHA-2453-MM (for Section 223(f)), must be valid and outstanding until project closing, i.e. endorsement of the permanent mortgage.
 - 1. No initial closing. Construction stage starts with the issuance of the Firm Commitment.
 - 2. Construction/rehabilitation must start within the period provided by the Firm Commitment.
 - 3. Extensions. See Chapter 11 for the extension of:
 - a. Construction period;
 - b. Firm Commitment expiration date, where required to permit project completion and final closing.
- C. Required documents include:
 - 1. Construction contract, Form HUD-92442 or HUD-92442-A. The following must be made a part of the contract:
 - a. General Conditions, AIA Document A201;
 - b. Supplementary General Conditions, Form HUD-2554;
 - c. Davis-Bacon Wage Rates (supplied by HUD Labor Relations);
 - d. HUD Amendment to the Construction Contract to Identify Identities of Interest Between Owner/Contractor/Subcontractor/Architect;
 - e. Cost certification criteria from Form HUD-92442-A, Article 10, where an identity of interest exists, or a "cost plus" form of contract is used.
 - 2. A complete master set of drawings and specifications and two duplicate sets;
 - 3. The Agreement and Certification, Form HUD-3306, executed by the mortgagor, Lender, and HUD.
 - 4. A title policy or title evidence showing:

- a. Insured property free of all encumbrances other than the mortgage and acceptable reservations of title;
 - b. Proof that no unpaid obligations exist except as previously approved by HUD;
 - c. Title policy continued to date of credit instrument endorsement.
5. Survey and Surveyor's Certificate, Form HUD-92457;
 6. Contractor's Requisition Project Mortgages, Form HUD-92448. The Contractor's Prevailing Wage Certificate must be submitted at the time the mortgage is presented to HUD for insurance.
 7. Assurance of funds to meet operating deficit. Completed Forms to assure funds are available to carry the project to a sustaining occupancy after final closing:
 - a. HUD-92476-A, Escrow Additional Contributions by Sponsor,
 - b. HUD-92476-1, Escrow Agreement, and
 - c. FHA-2477, Bond Guaranteeing Sponsor's Performance.
 8. Assurance of completion: Not applicable to insurance upon completion projects.
 9. Warranty against latent defects is required in accordance with Section 12.16.S below.
- D. The pre-construction conference must precede the initial start of construction. See Section 12.2.
- E. Construction monitoring and reporting must be done in accordance with Section 12.3.
- F. Labor and FHEO liaison. See Section 12.12.
- G. Contractor's monthly requisitions are not applicable to projects insured upon completion.
- H. Offsite construction:
1. Monitoring is recorded by the HUD inspector on Form HUD-95379.
 2. Advance of funds monitoring is not applicable to projects insured upon completion.
- I. Construction contract changes and Architect's supplemental instructions. See Sections 12.8 to 12.11 and 12.4.D. Construction changes are processed in the same manner as insurance of advances, except as modified below:
1. An escrow is not required for additive change orders, because HUD has no risk exposure until final closing. The mortgagor must be able to provide the additional funds required and must not have any outstanding obligation in connection with construction other than the insured mortgage at the time the mortgage is presented for insurance.
 2. Surety approval is not required for the approval of additive change orders regardless of the percentage of contract increase.
- J. Permission to Occupy applies as in Section 12.14.
- K. Final HUD representative's Trip Report falls under HUD procedures.

- L. Guarantee period falls under HUD procedures.
- M. Working capital deposit and operating deficit is not normally required for insurance upon completion projects. To mitigate any Departmental risk projects that apply for insurance upon completion must meet the operating deficit escrow and working capital requirements for projects with insurance of advances as outlined Chapter 8 Section 8.14. E & F, except for the extra 2% construction contingency portion of the working capital requirement.
- N. Property insurance schedule and requirements. When onsite construction is 80 percent complete (before endorsement of the credit instrument), the Lender must prepare:
 - 1. Property Insurance Schedule, Form HUD-92329, that:
 - a. Correctly shows the insurable value of the completed structures;
 - b. Reflects any changes in cost occurring after issuance of firm commitment.
 - 2. Property Insurance Requirements, Form HUD-92447.
- O. MIP is not charged until the project reaches final closing.
- P. Cost certification (See Chapter 13).
- Q. Closing must occur within the period provided in the commitment.
- R. Extension of Firm Commitment instructions are in Chapter 11.
- S. Builder's warranty. The general contractor must provide one of the following at final closing to assure correction of any latent defects:
 - 1. Cash escrow deposit of 2½ percent of the principal amount of the mortgage, to be retained in escrow by the Lender for a period of 15 months, or
 - 2. Surety bond in the amount of 10 percent of the cost of construction or substantial rehabilitation. The bond must run for 2 years after substantial project completion. The bond must be on Form HUD-3259, Surety Bond Against Defects Due to Defective Materials and/or Workmanship.

12.17**Completion of Repairs Pursuant to Section 223(f)**

- A. Required Repairs are documented by the Lender. (See Chapter 5, Section 5.26 and Appendix 5H). A list is prepared which categorizes repairs into critical repairs and non-critical repairs.
 - 1. Critical repairs must be completed before closing. Critical repairs are any individual or combination of repairs required to correct conditions that:
 - a. Endanger the safety or well-being of residents, visitors or passers-by;
 - b. Endanger the physical security of the property;

- c. Adversely affect project or unit(s) ingress or egress;
 - d. Prevent the project from reaching sustaining occupancy.
 2. Non-critical Repairs consist of all repairs other than Critical Repairs. Non-critical Repairs may, at the request of the mortgagor, be completed after closing.
 3. Completion of repairs.
 - a. Completion of repairs before closing. Require a site visit(s) and report(s) by a HUD representative to confirm satisfactory completion of required repairs before going to closing.
 - b. Completion of repairs after closing. Only non-critical repairs may be completed after closing. The following schedules are required:
 - (1) Schedule of Values for payment of completed repairs;
 - (2) Progress Schedule. All repairs must be completed within 12 months of loan closing;
 - (3) Schedule of Delayed or Interrupted Occupancy or Income, must list:
 - (a) All facilities for which occupancy or income will be delayed or interrupted by repairs delayed until after closing;
 - (b) Period of delayed or interrupted occupancy or income;
 - (c) Projected completion date for each facility having delayed or interrupted occupancy or income.
 4. Payment for Repairs.
 - a. Repairs completed before closing: No mortgage proceeds may be advanced.
 - b. Repairs completed after closing:
 - (1) A repair escrow account must be established. See Chapter 5, Section 5.26.D.2.
 - (2) The Schedule of Values for completed repairs will be provided to the HUD inspector, who will recommend progress payments from this Schedule as a part of the Trip Report, Form HUD-95379.
- B. Inspection of completed repairs is performed by the HUD inspector.
 1. Inspection Reports are filed on Form HUD-95379, HUD Representative's Trip Report, for each monitoring visit. The following are included in the Trip Report:
 - a. Non-compliance with provisions of the commitment or closing, e.g. work write-up, drawings, specifications, etc., including changes made to the work without prior approval;

- b. Adverse conditions e.g. slow work completion, destruction of work, new municipal requirements, disputes, etc.
 - c. Availability for use of facilities listed on the schedule of delayed or interrupted occupancy.
 - d. Municipal authorizations. Permissions to occupy use permits, etc. Where applicable, these must be issued before closing, unless related to work delayed until after closing;
 - e. Items of delayed completion. The HUD inspector must include:
 - (1) A detailed list of any exterior work;
 - (2) Recommended escrow amount;
 - (3) Recommended completion date (not later than 12 months after closing);
2. Assignment documents. The HUD inspector should assemble the following documents to monitor repairs and recommend payments:
- a. Firm Commitment;
 - b. Escrow agreement (where closing has occurred);
 - c. Survey, surveyor's report and legal description;
 - d. List of required repairs (work write-up);
 - e. Drawings and specifications (where required);
 - f. Schedule of Values (Required only for projects with repairs delayed after closing);
 - g. Progress schedule (Required only for projects with repairs delayed after closing);
 - h. Schedule of delayed or interrupted occupancy or income (Required only for projects with repairs delayed after closing);
 - i. Agreement and Certification.
- C. Repair completion. All work must be acceptably completed before the loan closing, except for the following:
1. Minor exterior work, which cannot be completed because of weather conditions, may be completed after closing, on projects for which prior provisions were not made for completion of non-critical work after closing. Include amount(s) to be escrowed.
 2. Non-critical repairs may be completed after closing when the commitment provides for it and a completion escrow is established at closing, except that:
 - a. All critical repairs must be completed before closing, and
 - b. An additional deposit must be made to the operating deficit account for all facilities for which delayed repairs will delay or interrupt occupancy or income for any period.
 3. Repair monitoring. All work must be monitored and accepted whether it is performed before or after closing.

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- D. Final report must be made upon completion of all work. The final report must show that:
1. All work is acceptably completed in accordance with the firm commitment and/or closing escrow, as applicable, and approved changes;
 2. Offsite work is completed or that the municipality has given written assurance for its completion;
 3. Utilities are connected;
 4. Permanent ingress and egress facilities are provided, and
 5. Applicable municipal inspections, approvals, etc., have been issued.
- E. Changes in the work, including associated cost changes, must be submitted by letter or other acceptable format. Form HUD-92437 may be used as a general guide, but the actual form must not be used.
1. Mortgagor, HUD and Lender must sign all changes;
 2. Contractor and mortgagor's Architect, if employed, must sign all changes.
- F. Guarantee inspections. Where the owner uses a contractor, rather than its own staff, to carry out repairs, guarantee inspections will be scheduled to discover and require correction of latent defects within 1 year of the date of final completion of all repairs. See Section 12.6.C.
- G. Projects in difficulty.
1. If the mortgagor has not completed all deferred repairs by the end of the repair period (including any approved extensions), the HUD Inspector will document all such non-completed repairs on Form HUD-95379, HUD Representative's Trip Report, and will submit the report to the Lender with a copy to the HUD CM.
 2. The Lender will complete the repairs using the escrowed funds. The Lender will submit a work schedule to HUD for the completion of all remaining repairs, and will provide the mortgagor with a breakdown of these repairs and the cost(s) of completion (including administrative expenses).
3. Funds remaining in the escrow account after completion of the repair work will be returned to the mortgagor less reasonable administrative costs incurred in completing the repairs.

CHAPTER 13

**SUMMARY OF MAJOR CHANGES IN CHAPTER 13 OF THE MAP GUIDE
Cost Certification**

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

There is a major highlights section in front of the Guide to direct/advise Field Office personnel and MAP Lenders as to the specific changes made to the Guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, **4470.2 Rev. 1 Cost Certification Guide for Mortgagees and Contractors of HUD-insured and Section 202/811 Multifamily Projects**), Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Additionally, all HUD forms used in the underwriting of a multifamily project have OMB approval.

Specific Chapter 13 revisions in the new release:

- Removal of Section 232 instructions
- Added provisions under HERA08 regarding cost certifications not being required on loans that have a loan amount to actual cost of less than 80%.

Chapter 13

Cost Certification

13.1

Projects that Must Certify

Cost certification is required by the National Housing Act and Regulations for all insured multifamily projects processed by MAP Lenders **except** for rental projects insured under Section 207/223(f) refinances where the mortgage is 80 percent or less of value **and** for certain projects assisted with Low Income Housing Tax Credits, where the Secretary has determined at the time of issuance of the firm commitment for insurance that the ratio of the loan proceeds to the actual cost of the project is less than 80 percent.

13.2

Purpose for Certification

The purpose for certification is to establish the mortgagor's actual costs, including contractor's cost, to establish the "maximum insurable mortgage" for final endorsement of the insured mortgage.

13.3

Certifiable Costs

Certifiable costs are those costs that have been paid in cash or will be paid in cash within 45 days of final closing, except for:

- A. Land Value which HUD will calculate,
- B. General Overhead which is certifiable whether or not it is paid in cash,
- C. BSPRA, which is cost certifiable whether or not it is paid in cash, where there is an identity of interest between the mortgagor and contractor, and
- D. Non-profit Developer's Fee, which is cost certifiable whether or not it is paid in cash, less amounts certified to and allowed on other line items.

13.4**Types of Cost Certification**

- A. Standard or "Long Form" Certification is required, except for projects permitted to use the "simplified" cost certification, and for certification of projects insured under Section 207.
- B. Simplified Certification is restricted to projects involving 40 units or less of proposed construction or substantial rehabilitation. Simplified Certification is used for Sections 207/223(f)
- C. Section 223(f) Certification is required for all projects insured under Section 207 except the certification is not required for Section 207/223(f) transactions, where the insured mortgage is 80 percent or less of the value.
- D. Section 223(f) Supplemental Certification is required for projects identified in paragraph C above, where completion of repairs is permitted after closing

13.5**Entities That Must Cost Certify**

- A. The Mortgagor must certify for all projects, except 207/223(f) refinances where the insured mortgage is 80 percent or less of value, **and** for certain projects assisted with Low Income Housing Tax Credit, where the Secretary has determined at the time of issuance of the firm commitment for insurance that the ratio of the loan proceeds to the actual cost of the project is less than 80 percent.
- B. Contractor must cost certify where:
 1. The Contractor has an identity of interest with the mortgagor, whether such identity of interest existed before the initial closing (for insured advances projects) or issuance of the Firm Commitment (for insurance upon completion projects), or the identity of interest developed after those dates; and/or
 2. The contractor used the Construction Contract-Cost Plus, Form HUD-92442A, whether or not any identity of interest with the mortgagor existed or came into being.
- C. Subcontractor at any tier, equipment lessor, material supplier, and manufacturer of industrialized housing must cost certify where:
 1. The total of all subcontracts, purchases, and leases are more than .5 percent of the mortgage, and
 2. An identity of interest exists or comes into being between such subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing and either:
 - a. The mortgagor, or
 - b. The contractor where the contractor must cost certify.

13.6**Sequence of Events**

- A. Notification of Pre-Cost Certification Conference. HUD must notify the mortgagee, mortgagor, and contractor when the project is 80 percent complete. HUD should notify new sponsors and general contractors as early as 70 percent completion. The letter should state that:
1. The mortgagor, general contractor, their accountants, and the mortgagee should attend the conference.
 2. Enclose with the letter the 800 number or the Internet address for:
 - a. Handbook IG 2000.4 Consolidated Audit Guide for HUD Programs.
 - b. Four copies of each of the applicable forms:
 - (1) Form HUD-92330, Mortgagor's Certificate of Actual Cost.
 - (2) Form HUD-92330A, Contractor's Certificate of Actual Cost, if applicable.
- B. Conduct of Conference is the responsibility of the assigned HUD Staff and should be held before the project is 90 percent complete. At the conference, HUD staff will explain:
1. Final completion, administrative completion, and cut off dates.
 2. Documentation required for cost certification including the income statement and balance sheet.
 3. Remind the mortgagor and accountant that they are responsible for computing the liquidated damages/actual damages and incentive portions, if applicable, of the construction contract using the certified amounts on HUD-92330.
 4. Necessity for a careful review and completeness of the documentation including dates and signatures, and timeliness of the submission, HUD review, and final endorsement.
 5. Any problems with prevailing wage certifications or other labor issues.
- C. Cut-off date established for computation of the cost certification.
- D. Submission and HUD approval of the cost certification must occur before final closing, except that the Section 223(f) supplemental cost certification is not required until completion of non-critical repairs deferred until after closing.
- E. Upon completion of the project, Form HUD-92464, Request for Approval of Advance of Escrow Funds should be prepared by the Lender and submitted to HUD for approval. The Lender does not approve (sign) this form on behalf of the Department.

13.7**Final Completion Date/Cut off Date**

- A. Final completion date for determining actual costs is the date the HUD inspector signs the final HUD Representative's Trip Report, Form HUD-95379, provided that the Construction Manager subsequently endorses the trip report. Construction must be complete, except for acceptable items of delayed completion. The mortgagor, general contractor, and mortgagee will be notified in writing of the final completion date.

1. The final completion date is the effective date for cost certification. However, the mortgagor has the option to include in the cost certification all soft costs incurred up to 60 days beyond this date. The date selected by the mortgagor is the "cut-off date" for the soft costs.
2. The mortgagor's balance sheet and operating statement date must agree with the selected cut-off date.

13.8**Administrative Completion Date**

The Hub Director may advance the completion date to prevent unnecessary accumulation of soft costs. This is done when projects nearly completed, face unnecessary delay.

- A. The Hub Director may set an administrative completion date for any project when the monthly inspection reports show 95 percent completion of work and thereafter less than 2 percent increase in percentage of completion in any month.
- B. The Hub Director notifies the mortgagor, general contractor, and mortgagee in writing of the administrative completion date and the following:
 1. The administrative completion date is the effective date for cost certification except that all soft costs up to 60 days beyond this date may be included at the option of the mortgagor.
 2. The date of the balance sheet and operating statement must be the same as the cut-off date selected by the mortgagor.
 3. Liquidated/actual damages for cost certification purposes will be computed using the administrative completion date. However, the general contractor is responsible for liquidated/actual damages through the date of final completion.
- C. Copies of the notification go to the Washington Docket, Office Docket, and Closing Attorney's file.

13.9**Submission Date**

Submission Date for cost certification should be within 30 to 45 days after the cut-off date and not less than 30 days before the desired final closing date.

13.10**Required Forms**

- A. Form HUD-92330, Mortgagor's Certificate of Actual Cost; see line-by-line instructions contained in the Forms Appendix.

- B. Form HUD-92330A, Contractor's Certificate of Actual Cost; see line-by-line instructions contained in the Forms Appendix. The subcontractor, material supplier, industrialized housing manufacturer, and the equipment lessor are required to use this form to certify cost.

Note: When a project includes rehabilitation and new construction, a separate form is required for each, with a master form summarizing total project costs, including fees.

- C. Form FHA-2205A, Mortgagor's Certificate of Actual Cost (Section 207 Pursuant to Section 223(f)), and line by line instructions are contained in the MAP Forms Appendix.

13.11

Required Statements and Certifications

Follow either A or B, below, depending on qualifications in A.1.

- A. Simplified Form of Cost Certification. Use Forms HUD-92330, HUD-92330A (if a cost plus construction contract was used or an identity of interest exists between the mortgagor and the general contractor). An accountant's opinion is not needed.
1. Simplified cost certification is permitted for new construction or substantial rehabilitation projects involving 40 units or less and for refinancing or purchase of existing properties under 207/223(f).
 2. If there is an identity of interest between a subcontractor, material supplier, equipment lessor, or manufacturer of industrialized housing and the mortgagor and/or general contractor who must cost certify, and the total of all identity of interest subcontracts, purchases and leases is more than 1/2 of 1 percent of the mortgage, the identified party uses Form HUD-92330A. This requirement established by the Agreement and Certification, Form HUD-3305/3306, applies in all cases.
 3. An un-audited balance sheet of the mortgagor entity, as of the cut-off date is required in all cases. Format and content of the balance sheet must follow paragraphs B.4 below.
 4. An un-audited operating statement is required if occupancy occurred during construction. Format and content of the operating statement must follow paragraphs B.5 below.
- B. Long Form Cost Certification. For cases that do not qualify for simplified cost certification based upon paragraph A.1 above, please submit the following:
1. Mortgagor's Certificate of Actual Cost, Form HUD 92330, supported by an accountant's opinion (refer to Section 13.11.B.6).
 2. Contractor's Certificate of Actual Cost, Form HUD-92330A, supported by an accountant's opinion (refer to Section 13.11.B.6), is required if there is an identity of interest with the mortgagor or if a cost plus construction contract was used.
 3. Subcontractors, suppliers, and equipment lessors with an identity of interest with either the mortgagor or general contractor must submit Form HUD-92330A supported by an accountant's opinion.
 - a. Material suppliers. Attach to Form HUD-92330A a sheet showing:

- (1) Quantities furnished.
- (2) Sources from which the materials were obtained.
- (3) Unit prices paid to the sources, brand names, model numbers, sizes, lumber grades, etc., as applicable.

NOTE: No amount will be included for general requirements (job overhead).

b. Equipment Lessor. Attach to Form HUD-92330A a sheet showing:

- (1) Dates the equipment was acquired,
- (2) Age of equipment at acquisition date,
- (3) Brand names and model numbers,
- (4) Sizes,
- (5) Dates and length of time used, and
- (6) Rates charged.
 - (a) The Lessor(s) must certify that:
 - (i) The rates charged were not more than the local going rate obtainable in the area, including any maintenance and repair.
 - (ii) The time charged was not more than essential for the project.
 - (iii) The charges did not exceed the purchase price of the equipment.
 - (b) Lump Sum Basis. Instead of providing an attachment containing the above information, the lessor(s) may elect to certify to charges at 85 percent of the local going rates for identical equipment under arms' length (lump sum) leases. When using this alternative, the lessor agrees:
 - (i) The Hub is the sole judge of the reasonableness of the time and rates charged, and
 - (ii) Equipment maintenance and repair expense is the responsibility of the lessor(s) and is not included as an additional cost.
 - (c) Subcontractor's equipment. Costs for subcontractor(s) equipment, whether owned or rented, are considered in the markup for overhead and profit. These costs shall be reflected in the total subcontract and in the prior approval of identity of interest entities. A separate certification of the equipment is not required.

- (d) Manufacturer of Industrialized Housing. Attach to Form HUD-92330A, a breakdown of Division 13, Special Construction showing:
- (i) Manufacturing costs.
 - (a) Labor
 - (b) Materials
 - (c) Sales and any other taxes
 - (d) Factory overhead
 - (e) General overhead and profit

NOTE: The manufacturer's accounting system must follow generally accepted accounting procedures, which will allow certification of the actual cost of manufacturing by a Certified Public Accountant or Independent Public Accountant. No amount will be included for transportation or work at the project site.

- (ii) Transportation costs, factory to project site (if provided by manufacturer).
 - (a) Labor
 - (b) Equipment
- (iii) On-site erection costs (if provided by manufacturer).
 - (a) Labor
 - (b) Equipment
 - (c) Materials
 - (d) General requirements (job overhead)
- (iv) The remainder of the manufacturer's Form HUD-92330A is completed per outstanding instructions.

NOTE: There can be no duplication of manufacturing costs, i.e., repair of components damaged in shipment.

4. An audited balance sheet of the mortgagor entity, as of the cut-off date is required.
- a. The balance sheet must contain the following certification

I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the mortgagor [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of

(Name of mortgagor or owner) financial position as of _____ (date of financial statement).

Signed this ___ day of _____, 200X__

_____ (Signature of authorized agent with name printed or typed under signature)

WARNING: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18U.S.C. 1001, 1010, 1012; 31U.S.C. 3729, 3802)

- b. Furnish reconciling information if short-term liabilities on the balance sheet do not agree with Column B of Form HUD-92330.
 - c. Explain the purpose of all liabilities in the notes to the financial statement and include repayment requirements of the liabilities. Take special care to note any liabilities included for repayment on the balance sheet that were not disclosed during the firm processing stage or before initial endorsement. If such liabilities are found inform the mortgagor that the liabilities cannot be an obligation of the project; repayment is the responsibility of the mortgagor. These liabilities will not be considered (allowed nor disallowed) in the review of the cost certification. When non-disclosures are found it requires a detailed review of cost certification Forms HUD-92330 and HUD-92330A.
 - d. If proceeds and obligations from project syndication are passed through the books and records of the mortgagor entity, reflect receivables as an asset of the mortgagor entity.
 - e. The notes to the balance sheet must identify the original amount of and summarize the expenditures from the working capital deposit.
5. An audited operating statement is required if occupancy occurs before the cost certification cut-off date.
- a. The statement must contain the certification contained in Section 13.11.B.4.
 - b. Prepare the operating statement on an accrual basis.
 - c. The statement covers the beginning of marketing and rent-up activities (or date of initial endorsement in rehabilitation projects where occupancy is continuous) to the cut-off date.
 - d. Marketing and rent-up activities will start no earlier than 6 months before the issuance of the first Permission to Occupy-Project Mortgages, Form HUD-92485.
 - e. The statement must show the actual dates covered rather than language such as "From the Date of Commencement of Marketing and Rent-up Activities, etc."
 - f. The statement must show income from all sources. Do not consider security deposits as income.
 - g. The operating statement should not contain any expense items that were paid or should have been paid from the working capital deposit or otherwise included in cost certification.
 - h. Operating expenses may include:
 - (1) Expenses directly relating to renting the project, such as:
 - (a) Rental commissions customary for the type of project, if any, and

- (b) Marketing and advertising expenses.
- (2) Purchase of furnishings, equipment not paid from the working capital deposit, and supplies essential to project operation.
- (3) Reasonable fees for preparing any Federal, State, or local tax return information required of the project.
 - (a) For example: If the mortgagor entity is a partnership, the cost of preparing both Form 1065, U.S. Partnership Return of Income, and related K Schedules may be considered. Do not recognize the cost of preparing a partner's personal Form 1040 return.
 - (b) For projects owned by an individual include the cost for preparing any tax return schedule related to project operations; but do not other parts of the owner's return.
- (4) Electricity, gas, water, and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.) to the extent they are not included in construction cost of Form HUD-92330, Mortgagor's Certificate of Actual Cost, or HUD-92330A, Contractor's Certificate of Actual Cost.
- (5) Management fee stated in the contract.
- (6) Services not covered by the management fee under Chapter 3 of Handbook 4381.5, Compensations for Management Services in Multifamily Housing Projects with Insured or HUD-Held Mortgages.
- i. Operating expenses may not include:
 - (1) Depreciation
 - (2) Interest, taxes, property insurance premiums, and mortgage insurance premiums that are reflected in Form HUD-92330, Mortgagor's Certificate of Actual Cost.
 - (3) Salaries paid to principals of the sponsor or mortgagor for managing the mortgagor entity.
- j. Treat net income:
 - (1) As a recovery of construction costs for profit motivated mortgagors.
 - (2) For a nonprofit mortgagor:

- (a) As a recovery of construction costs at cost certification, to the extent that it was used to reduce liquidated/actual damages.
 - (b) As an offset for a mortgage increase.
 - (c) Deposit the unused portion of net income into the reserve for replacement at final endorsement.
- k. If operating expenses exceed income:
 - (1) No entry is made on Form HUD-92330, Mortgagor's Certification of Actual Cost.
 - (2) Operating deficit may be carried over as a reduction to net income on the supplemental operating statement.
- 6. A Certification by an independent Certified Public Accountant or an Independent Public Accountant must accompany Form HUD-92330, Mortgagor's Certificate of Actual Cost, including the audited balance sheet and operating statement of the mortgagor, and Form HUD-92330A, Contractor's Certificate of Actual Cost.
 - a. The accountant must meet the auditor qualifications of the Government Auditing Standards (GAO Yellow Book), including the qualifications relating to independence and continuing professional education. The audit organization also must meet the quality control standards of the GAO Yellow Book.
 - b. Part 24 of Title 24 of the Code of Federal Regulations prohibits accountants from contracting for services when their name is shown on the HUD and General Services Administration Government-wide Consolidated List of Debarred, Suspended and Ineligible Contractors and Grantees.
 - c. The accountant must also comply with the requirements in Chapters 1, 2, and 6 of HUD Handbook IG 2000.4, "Consolidated Audit Guide for Audits of HUD Programs."
- 7. The mortgagor must submit a supplemental operating income statement if more than 3 months exist between the cut-off date and the start of amortization. If a deferment of amortization was granted, use the new date for the start of amortization in determining the need for a supplemental operating statement.
 - a. This requirement does not apply to nonprofit mortgagors, nor any project where the mortgage is \$200,000 or less.
 - b. The statement covers the period from the cost certification cut-off date to the date, which is 3 months before the start of amortization. The mortgagor should submit the statement within 30 days after the expiration of this period.
 - c. If the required original cost certification was audited, a CPA or IPA must prepare and certify the supplemental statement.
 - d. The mortgagor may advance the date of amortization to avoid submitting a supplemental income statement.

- e. In preparing the statement, if the operating statement submitted at cost certification shows expenses in excess of income, such expenses may be carried forward as "un-recovered expense—prior period."
- C. Section 223(f) Projects. The mortgagor certifies to the total costs incurred in the acquisition or refinancing of the property using Form FHA-2205-A, Mortgagor's Certificate of Actual Cost. The certification must be dated and signed by an authorized agent of the mortgagor. An accountant's opinion is not needed.
- 1. The certification must be submitted after all critical repairs have been completed, but at least 15 days before the desired closing date.
 - 2. The general contractor will be required to cost certify using Form HUD-92330A if a cost plus construction contract is used.
 - 3. A balance sheet and income statement are not required.
 - 4. No cost certification is required for a 207/223(f) refinancing transaction where the mortgage is equal to or less than 80 percent of value.
 - 5. For cases involving deferred repairs, the mortgagor must submit a supplemental cost certification (Form HUD-2205-A) detailing the actual cost of the deferred repairs.

13.12**Deficiencies in Cost Certification Submission**

When the cost certification package is received for processing:

- A. The Cost and Mortgage Credit reviewers will:
 - 1. Determine deficiencies associated with the mortgagors' and contractor's cost certifications.
 - 2. Advise the Hub Director and estimate the time needed to resolve the problem(s).
 - 3. Attempt to resolve all problems by telephone before making a formal written request. This usually allows processing to continue while waiting for a formal reply.
 - 4. Send a letter within 5 workdays to the mortgagor with copies to the general contractor (if applicable), their accountants, and the mortgagee stating the deficiencies and requesting information.
- B. Upon receipt of all necessary information, combined processing should not exceed 15 workdays.
- C. If the mortgagor or contractor indicates clarification will be forwarded within 5 work days, the conclusions of cost certification can await the additional information.
- D. If not, issue Form HUD-92580.

13.13**HUD Mortgage Credit Limited Review**

- A. In cases where the mortgagor has not requested a mortgage increase, the HUD staff will:
 - 1. Review Form HUD-92330, Mortgagor's Certificate of Actual Cost. Adjust for items paid out of working capital and costs reflected on income statement.

2. Review the reporting of:
 - a. Net income earned before the start of amortization. Report all income earned from the beginning of marketing and rent-up activities to the cut-off date for new construction projects and unoccupied substantial rehabilitation projects. For substantial rehabilitation projects where occupancy is continuous, report all income from the date of initial endorsement or, for insurance upon completion cases, the start of construction to the cut-off date. Make adjustments for ineligible reported expenses, i.e., depreciation.
 - b. The reporting of all grants/loans received for replacement cost items.
3. Complete Form HUD-92580, Maximum Insurable Mortgage, using the figures from Column C, Total, of Form HUD-92330. Complete the forms using the instructions in the MAP Forms Book, except for the following changes:
 - a. Line 2. Reflect the amount indicated in Column C of Form HUD-92330.
 - b. Line 3. Explain any adjustments made to the net income or grant/loan amounts reported on Form HUD-92330.

NOTE: If adjustments are made to items other than net income and grants/loans, Form HUD-92331A should be completed.
4. Report anything suspicious in the submission, (i.e. liabilities not disclosed during firm processing or before initial endorsement) to the Hub Director, who has the authority to request that a full cost certification review be completed. For such cases, complete Forms HUD-92331-A, and HUD-92580 based on the instructions in the MAP Forms Book and Section 13.14 of this Chapter. Also, if an accountant's work is consistently deficient, warn the accountant that mortgageors using their services will be advised that HUD will perform a detailed cost certification review.

13.14**HUD Mortgage Credit Detailed Review**

When a mortgage increase is requested of the Hub Director, a more detailed review is required. The HUD Mortgage Credit staff will:

- A. Carefully review Forms HUD-92330 and HUD-92330-A if required for mathematical accuracy and compliance with prescribed procedures.
- B. Ensure that the submission contains required schedules and bills, which have not been submitted with previous draw requests, to support the certified amounts for interest, taxes, property insurance, MIP, title and recording, financing fees, legal, organizational and audit fees, offsite costs and other fees.
- C. Require clarification or breakdown of all, or any part of, the cost figures presented by the mortgageor or general contractor, if applicable.
- D. Question the existence of any identity of interest subcontractor, material supplier or equipment lessor.

- E. Review the notes and schedules attached to the accountant's opinion. Pay special attention to any liabilities included for repayment on the balance sheet that were not disclosed during the firm processing stage or before initial endorsement. These liabilities are not eligible for inclusion in the cost certification.
- F. Recommend that the Hub Director request an audit of the mortgagor's and/or contractor's books by the Regional Inspector General for Audit before issuing Form HUD-92580, Maximum Insurable Mortgage, when differences of opinion arise from other than:
 - 1. Genuine misunderstanding of HUD instructions.
 - 2. Honest differences of opinion clearly identifiable as such.
 - 3. Other justifiable causes.
- G. If considerable time has passed between initial occupancy and the cut-off date, some items properly allocable to renting and operating the project may be charged against construction cost.
 - 1. It may not be possible or practical to make precise allocation of such items as gas and electricity, clean-up costs, etc., between construction and operation periods.
 - 2. Insist on reasonable allocation(s) and eliminate duplicate claims for the expenses under both categories.
- H. Advise Cost staff of any construction costs included in "Miscellaneous" and "Other" categories of Form HUD-92330.
- I. Check items and amounts in the mortgagor's cost certification without auditing the mortgagor's books and records. An audit may be needed later. (Refer to Section 13.27)
- J. Record the results of the review on Form HUD-92331A, Cost Certification Review Worksheet.

13.15**Allowable Costs in Form HUD-92330, Mortgagor's Certificate of Actual Cost**

- A. Construction Contract:
 - 1. A lump sum construction contract is permitted when no identity of interest exists between the mortgagor and general contractor. The amount allowed in cost certification is the lesser of:
 - a. Actual cash paid or to be paid by the mortgagor under the construction contract.
 - b. Contract price as adjusted by HUD's estimated cumulative effect of approved change orders paid, or to be paid, by the mortgagor and the liquidated/actual damages provision to the contract, if applicable.
 - 2. A cost-plus construction contract is required when an identity of interest exists between the mortgagor and general contractor.
 - 3. The amount allowed in cost certification when a cost-plus contract is used is the lesser of:
 - a. Actual cash paid, or to be paid, by the mortgagor under the construction contract.

- b. Amount the cost analyst allowed for construction on Form HUD-92331, Summary of Cost Certification Review–Cost Section.
- c. Contract price as adjusted by the HUD estimated cumulative effect of approved change orders paid, or to be paid, by the mortgagor and, if applicable, either the incentive provision or the liquidated/actual damages provision of the contract.

NOTE:

- (1) Recognize approved change orders necessitated by errors or omissions by the architect only to the extent there are savings in the mortgage. Do not recognize these change orders when processing a mortgage increase.
 - (2) Do not recognize approved betterment change orders in calculating the adjusted upset price in paragraphs A.1.b and A.3.c, unless they are determined by the Cost staff to be necessary changes as defined in Chapter 12, Section 12.8.
 - (3) Recognize the increase in general requirements, if any, noted on approved time extension change orders. Do not recognize increases in soft costs associated with the change order. The soft costs will be recognized under the applicable line items.
 - (4) When BSPRA is not applicable, for profit motivated projects involving an identity of interest between the mortgagor and general contractor, the amount of builder's profit as shown on Form HUD-3305 or HUD-3306 is eligible whether or not it was paid in cash.
 - (5) For nonprofit mortgagors, the allowable builder's profit is the lesser of the amount actually paid or to be paid in cash to the general contractor or the amount of builder's profit shown in Section G of Form HUD-92264, plus or minus any amount applicable due to HUD-approved change orders.
4. An identity of interest is construed to exist when:
- a. There is any financial interest of the mortgagor in the general contractor or any financial interest of the general contractor in the mortgagor.
 - b. Any officer, director, or stockholder or partner of the mortgagor is also an officer, director or stockholder or partner of the general contractor.
 - c. Any officer, director, stockholder, or partner of the mortgagor has any financial interest in the general contractor; or any Officer, director, stockholder, or partner of the general contractor has any financial interest in the mortgagor.
 - d. The general contractor advances any funds to the mortgagor.
 - e. The general contractor supplies and pays, on behalf of the mortgagor, the cost of any architectural services or engineering services other than those of a surveyor, general

- superintendent, or engineer employed by a general contractor in connection with its obligations under the construction contract.
- f. The general contractor takes stock or any interest in the mortgagor corporation as consideration of payment.
 - g. There exists or comes into being any side deals, agreements, contracts, or undertakings entered into or contemplated, thereby altering, amending, or canceling any of the required closing documents, except as approved by the Secretary.
 - h. Any relationship (e.g. family) existing which would give the mortgagor or general contractor control or influence over the price of the contract or the price paid to the subcontractor, material supplier or lessor of equipment.
5. Incentive. The construction contract may be modified before initial endorsement to provide for a contractor's incentive when construction is completed before the date specified in the construction contract (as amended by HUD-approved time extensions).
- a. Identity of interest mortgagor and general contractor.
 - (1) General contractor may benefit from savings in construction interest, taxes, property insurance, and mortgage insurance premiums to the extent there are construction cost overruns.
 - (2) Incentive payment is included in the adjusted upset price of the construction contract.
 - b. Nonidentity of interest mortgagor and general contractor.
 - (1) Use Construction Contract Incentive Payment, Form HUD-92443.
 - (2) Include the incentive payment under "Other" on Form HUD-92331A.
6. Damages Clause. Apply the damages clause of the construction contract when the general contractor does not complete the project on time. The clause holds the general contractor financially responsible for the added soft costs resulting from the contractor's delay.
- a. Calculate the amount of actual damages and liquidated damages, using the lesser to determine the adjusted upset price.
 - b. To determine actual damages, compute the actual cost of interest, taxes, insurance, and MIP for the period from the scheduled completion date (as amended by HUD-approved change orders) through the final completion date.
 - c. To determine liquidated damages multiply the daily liquidated damages rate from the construction contract by the number of days between the scheduled completion date specified in the construction contract, as amended by the HUD-approved time extensions, through the final completion date.
 - d. Reduce the damages by the portion of the net operating income earned during the liquidated/actual damage period.

- e. For those cases where an administrative completion date has been established, use this date for computing damages for cost certification purposes. However, the general contractor is responsible for damages through the date of final completion.
7. If a mortgagor acts as its own general contractor:
 - a. A construction contract is not executed. Instead, Form FHA-2441-Supplement is added to the Building Loan Agreement, Form HUD-92441.
 - b. The upset price for construction is line 51 of the approved Form HUD-2328, Contractor's and/or Mortgagor's Cost Breakdown (Schedule of Values), as adjusted by the cumulative effect of HUD-approved change orders and the incentive provision, if applicable.
 - c. Incentive clause, if any, is incorporated by addendum to Form FHA-2441-Supplement.
 - d. There is no liquidated/actual damages clause.

NOTE: The mortgagor may serve as its own general contractor only when the mortgagor is an individual or a general partnership.

8. Incomplete Minor Items. The mortgagor's certification of the amount due under the terms of the construction contract may include the cost of minor items of on-site work that remain incomplete under the construction contract.

B. Architect's fee(s) are limited to the amounts paid in cash.

1. Recognize the cost of additional services set forth in Article 10 of the Standard Form of Agreement between Owner and Architect for Housing Services, AIA Document B181. Ask Architectural and Cost staff to check the reasonableness of these charges.
2. Disallow:
 - a. Any portion of the Architect's fee paid in stock.
 - b. Any costs associated with a clerk of the works.
3. If any identity of interest comes into being between the Architect and either the mortgagor or general contractor during project construction:
 - a. See maximum design Architect's fee for cost certification purposes set forth in the Agreement and Certification, Form HUD-3305 or HUD-3306.
 - b. Do not allow a fee for supervisory services to an identity of interest Architect.
4. Treat any unused balance of the total Architect's fee as a direct mortgage reduction to the original mortgage amount on Form HUD-92580.

C. Interest is allowable in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Section 14.7.

1. Recognize interest costs associated with an approved early start provided:
 - a. The mortgagor entered into an agreement with the contractor which:
 - (1) Was approved by the Hub Director.

- (2) Agrees to reimburse the contractor for interest on money borrowed for construction prior to initial endorsement.
 - (3) States that reimbursement will be made only to the extent the mortgagor has funds available in the amount estimated for interest during construction.
 - b. The certified amount, when added to the interest cost incurred directly by the mortgagor, does not exceed the total amount of interest estimated in Section G of Form HUD-92264.
 - c. Form FHA-2415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, was executed and approved.
 - d. Interest costs reflect the contractor's actual cost of money borrowed to cover the cost of construction between the early start date and the initial endorsement as adjusted by paragraph e. below.
 - e. Rate of interest does not exceed rate established for the insured loan.
 2. Interest rate paid on the construction loan cannot exceed:
 - a. For insurance of advances: the rate stated in the Firm Commitment.
 - b. For insurance upon completion: the rate acknowledged by the Hub Director before issuing the Firm Commitment.
 3. Deduct accrued interest forgiven by the lender or otherwise not paid in cash.
 4. Treat lender/bond underwriter's refund of any portion of the construction loan interest to the mortgagor or sponsor, as a direct mortgage reduction to the original mortgage amount on Form HUD-92580.
 5. If the construction interest rate changes before initial endorsement and it was not feasible to reprocess the project or if a State Housing Agency sold bonds to finance the construction loan and the true interest rate was not known until cost certification:
 - a. Interest savings may be created from the difference between the processed interest rate and the actual final interest rate.
 - b. Treat these savings as a direct mortgage reduction if the following condition was included in the firm commitment:

“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.”
 6. Neither the interest on subordinated liens nor other obligations of the mortgagor are allowed as certifiable costs.
- D. Taxes are allowable in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Section 13.7. Do not recognize costs accrued during early start period.

- E. Property insurance is allowable in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Section 13.7. Do not recognize costs accrued during early start period.
- F. Mortgage Insurance Premium (MIP). The FHA Comptroller's office cannot compute the exact amount of MIP due during the construction period until the project has been completed and the Washington Docket forwarded to Headquarters.
1. For a project involving insurance of advances, allow MIP of $\frac{1}{2}$ of one percent per annum on the mortgage amount on the basis of accrual for the number of days in the period used to Paragraph C above, when applicable.
 2. For a project involving insurance upon completion, no MIP is paid during construction.
- G. HUD application, commitment and inspection fees are allowable in the amounts paid. Fees paid to reopen an expired or terminated commitment are not allowable costs.
- H. Financing expense includes the initial service charge, discounts fees, FNMA or GNMA or other permanent lender commitment and marketing fees, and other similar fees.
1. Allow the lesser of:
 - a. Amounts paid, or to be paid, in cash.
 - b. Amounts shown on Form HUD-2434, Mortgagee's Certificate, or Certificate of Mortgagee portion of Form FHA-2455 and approved by the Hub Director before initial endorsement (Insurance of Advances) and issuance of Firm Commitment (insurance upon completion), respectively.
 2. Construction Lender's initial service charge (usually 2 percent):
 - a. Is expected to cover:
 - (1) Processing fees.
 - (2) All expenses of the Lender's counsel paid directly from the initial service charge. (Reconcile separate invoices or bills with the cost of the itemized figures.)
 - (3) All other charges by the construction lender.
 - b. Excludes:
 - (1) Construction loan discount.
 - (2) Construction loan extension fees.
 - c. Any charges made by the Lender for payment of counsel services or charges paid directly to the Lender's counsel, to the extent they cause the initial service charge to exceed 2 percent, are not certifiable. Except, if charges are related to "Title and Recording" expenses certify it under Section 13.15.I below.
 3. Permanent Lender's placement fee (usually 1.5 percent):
 - a. Is expected to cover all permanent placement expenses except discounts and some of the fees associated with a bond financed transaction.

- b. If GNMA Mortgaged Backed Securities are involved, the mortgagee may not assess an additional charge for the MBS application fee or for the custodial or delivery fee.
- NOTE: Construction and Permanent Lenders' fees in the aggregate shall not exceed 3-1/2 percent (5.5 percent for bond financed projects) and the parties involved can divide as agreed upon.
4. Recognize for cost certification:
- a. Reasonable discounts (Based upon current interest rate levels at the time of issuance of the Firm Commitment for projects involving insurance of advances and insurance upon completion.) charged by the construction and permanent lenders. Recognize extension fees charged by the construction lender if funded at initial endorsement and shown on the Mortgagee's Certificate, Form HUD-2434.
 - b. Permanent lender extension fees, shown on Form HUD-2434, if funded before the final completion date.
 - c. For insurance upon completion cases, construction and permanent loan extension fees, shown on the Certification of Mortgagee portion of Form FHA-2455, if funded before cost certification cut-off.
 - d. Financing fees (including extension fees and discounts) paid on behalf of a mortgagor by a third party under Paragraph 18(f) of the Mortgagee's Certificate or Paragraph 10h of Certificate of Mortgagee portion of Form FHA-2455 and shown as a current liability on the mortgagor's balance sheet to the extent there are savings in the mortgage. At final endorsement, require a promissory note be used for any unpaid balance of the obligation recognized in cost certification.
 - e. For bond financed projects, cost of issuance, discounts, and financing fees in excess of 5-1/2 percent; provided the cost certification evidences that the sponsor/mortgagor cannot benefit monetarily from excess investment income from the proceeds of the invested obligations. Refer to Chapter 8, Section 8.15.
5. Do not recognize for cost certification:
- a. Any "side deals" (except for approved discounts) by which the mortgagor agrees to pay for the "added cost of money."
 - b. The cost of purchasing of FNMA stock.
 - c. The 4 percent construction loan and 1.75 percent permanent loan GNMA indemnification escrows.
 - d. Discounts required to buy down the construction and/or permanent rate to a below market rate.
6. Treat the following as a direct mortgage reduction at final endorsement:
- a. Premiums paid by Lender to the mortgagor or sponsor for acquiring the construction or permanent loan.
 - b. Partial refunds of the Commitment fee allowed in processing, which are returned to the mortgagor or sponsor.
 - c. Discounts or other fees paid for by a contribution of a portion of the initial service charge by the Lender/bond underwriter.

- d. Rebates paid to a mortgagor or sponsor by the Lender/bond underwriter for bond -financed mortgages.
- I. Title and recording expense is limited to cash paid for:
 1. Title search and policy at the time of initial endorsement;
 2. Recording fees at initial endorsement;
 3. Mortgage and stamp taxes;
 4. Survey recording fees;
 5. Updating title policy during construction;
 6. Final title policy and recording charges; and
 7. Legal fees incurred with any of the above.
 - J. Legal, organization and audit expenses are limited to expenses incurred in organizing the mortgagor entity, developing the proposal to submit to HUD and other necessary governmental agencies and required services during closing and construction.
 1. Organizational allowance:
 - a. Allow only the amount included in Section G of Form HUD-92264 for the organizational fee, unless the mortgagor, which justifies the need for, and reasonableness of the additional expenditure submit fully supporting documentation.
 - b. Any costs incurred in excess of this allowance are not eligible for recognition in processing a mortgage increase or the equity computation on Form HUD-92580.
 2. Limit the Mortgagor's legal expenses to those incurred for: initial through final closings; tax advice during organization of mortgagor entity only; and preparation of documents and representation for and during organization of the mortgagor entity.
 - a. Allow customary expenditures expected to be incurred before and during initial closing, construction period, and final closing.
 - b. Do not allow:
 - (1) The usual expenses connected with land acquisition which is already included in, or contributing to:
 - (a) Title and recording expense.
 - (b) Estimated market price of site.
 - (c) Obtaining changes in zoning.
 - (2) Cost of legal services to create tax shelters, trusts, etc.
 3. Recognize cost of a "package deal" for organization and legal services provided:
 - a. Supplier is qualified to furnish the needed services.
 - b. Do not allow duplicate credit for the same services.

4. Audit fee covers the cost of the accountant's audit and opinion of the mortgagor's certificate of costs.
 5. Amounts included in Form HUD-92264 for legal and audit expenses are not blanket allowances, but ordinarily set an upper limit on allowable amounts.
 - a. Non-typical fees must be borne by the mortgagor, unless in an exceptionally complex case, a higher fee is proven by the mortgagor to be necessary and reasonable. Detailed invoices and/or other documentation is required as to the reasonableness, purpose, necessity, and proper classification of all items in the category.
 - b. This limitation is not flexible where a "package" for legal and organizational services is involved or where a substantial amount of the legal and organizational services are performed by the same firm.
- K. Offsite Costs. Where the mortgagor enters into a supplemental contract for constructing offsite improvements, allow the lesser of:
1. Contract price as adjusted by the HUD's estimated cumulative effect of approved offsite change orders.
 2. Actual cash paid or to be paid for offsite work.
 3. Amount allowed by cost analyst for offsite construction of Form HUD-92331, Summary of Cost Certification Review - Cost Section.
- NOTE:
- a. The Valuation Branch must adjust the as-is land value of the property, if the allowed amount for offsite and demolition differs from HUD's estimate on Form HUD-92264 issued at Firm Commitment.
 - b. Offsite costs are not allowable for leasehold estates when the ground rent is based on a land value that reflects all required offsite improvements since the mortgagor has not paid for those improvements.
 - c. If the mortgagor certifies to off-site costs, the land value entered on Form HUD-92580, "Maximum Insurable Mortgage" will be reduced by the amount of off-site costs.
- L. Other Costs include all costs and/or recovery of costs which are not provided for elsewhere and which are clearly attributable to the actual cost of the project.
1. Cost of acquiring the leasehold interest provided the acquisition cost plus ground rent and offsite costs paid by the mortgagor, if any; do not exceed the HUD Fair Market Value of the Land Fully Improved. Any excess is to be reflected as a disallowed cost of acquiring the leasehold.
 2. Ground rent paid during the period of the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date as defined in Section 13.7.
 3. Incentive payment due a nonidentity of interest contractor for completing construction before the scheduled completion date as amended by HUD-approved change orders.
 4. Compensation from an insurance claim including any income earned by investing the proceeds of the claim. Treat as recovery of cost after computing BSPRA.

5. Contractor's bond premium if paid by the mortgagor. If the construction contract contained an amount for the bond premium, subtract it from the contract amount when developing the adjusted upset price on line 1c of Form HUD-92331A.
6. Other fees, including engineering and topographical survey. Cost staff must determine if such costs are reasonable and not duplicated in the general contractor's costs.
7. Contingency reserve is included in the replacement cost of substantial rehabilitation projects.
 - a. The contingency reserve may be used for unforeseen costs of necessary change orders approved by HUD and unanticipated soft costs for time extensions approved by HUD.
 - b. Expenditures for change orders and shortfalls in soft costs should be certified to and allowed under those specific line items.
 - c. Normally there will not be an amount certified to under contingency reserve since all expenditures will be certified to on other line items.
 - d. An itemization of all expenditures covered by contingency reserve funds must be attached to the cost certification submission.
8. Grants, loans or tax credits to the mortgagor entity and/or principals of the mortgagor entity used to pay for allowed items of cost.
 - a. Treat as a recovery of cost after BSPRA.
 - b. Do not deduct grant, loan or tax credit funds from the total recognized costs when the funds were used to pay for the non-replacement cost items, i.e., used toward but not limited to: paying the acquisition cost of the land in excess of the HUD allowance, the operating deficit, working capital and items on Form HUD-2880, Applicant/Recipient Disclosure.
9. Residential relocation fund established on Form HUD-92264. Allow only those expenses approved by the HUD CPD relocation specialist up to the amount established on Form HUD-92264. Apply unused allowance as a direct mortgage reduction.
10. Third party costs for appraisals, market analysis, PCNA etc., are no longer recorded in Other Fees. Include them in with Organizational Cost line items. Refer to Chapter 3.

M. Builder's and Sponsor's Profit and Risk Allowance (BSPRA)

1. HUD does not control the division of BSPRA.
2. Compute without regard to amounts on Form HUD-92264. Base the BSPRA computation on a percentage of allowed costs.
 - a. Use the same percentage (not to exceed 10 percent) used to compute BSPRA in the Firm Commitment review.
 - b. Exclude from the computation the cost of off-site work, land, payments for acquisition of leasehold, ground-rent, relocation expenses, and supplemental management funds, and Major Moveable Equipment, if applicable.
3. 50/75 percent rule.
 - a. Whether or not there is an identity of interest, no general contractor's fee (general overhead and profit) will be allowed when:

- (1) More than 50 percent of the contract sum in the Construction Contract–Cost Plus, Form HUD-92442-A, is subcontracted to one subcontractor, material supplier or equipment lessor, or
- (2) 75 percent or more with three or less subcontractors, material suppliers and equipment lessors.

NOTE: If two or more subcontractors have common ownership, they are considered as one subcontractor.

- b. Exceptions: The fifty/seventy-five percent rule is not applicable to:
 - (1) Manufacturers of Industrialized Housing.
 - (2) Trade items performed by persons on general contractor's payroll.
 - (3) Mobile Home Park program.
 - (4) Supplemental Loan program.
 - (5) Rehabilitation programs other than gut rehabilitation.
 - c. The cost analyst determines the applicability of the 50/75 percent rule.
 - d. Where the 50/75 percent rule is violated, the general contractor forfeits its profit and only Sponsor's Profit Risk Allowance (SPRA) is allowed.
 4. Where there is no identity of interest between the mortgagor and builder or when the 50/75 percent rule has been violated, compute a SPRA which is 10 percent of allowable:
 - a. Architectural fees.
 - b. Carrying charges and financing.
 - c. Legal, organization, and audit expenses.
 5. If an identity of interest between the mortgagor and general contractor is established after initial endorsement and exists at the time of final completion, BSPRA is allowed in lieu of a builder's profit and SPRA.
 6. If prior to the final completion date an identity of interest no longer exists between the mortgagor and builder, substitute SPRA for BSPRA.
 - a. The construction contract may be amended to permit a typical builder's profit.
 - b. Treat the difference between BSPRA and the combination of SPRA and builder's profit as a direct mortgage reduction on Form HUD-92580.
- N. Non-profit Developer Fee. The allowable amount is the amount included in the Firm Commitment less amounts certified and allowed on other line items.

- A. Actual costs are all costs, paid by the general contractor under the Construction Contract for completion of the project, and to which the general contractor certifies, using Form HUD-92330A.
1. Include actual costs paid in cash, or to be paid in cash (items of delayed completion), within 45 days after the date of the substantial completion, for labor, materials, equipment, subcontract work, general requirements (job overhead), fees and general overhead. Also include amounts estimated for any items requiring an escrow.
 - a. General Requirements:
 - (1) May include salaries of clerical staff for time actually spent at the project site. Prorating of annual salaries on the percent basis is not permitted.
 - (2) Salaries of executives may not be included in General Requirements. Such salaries are included in General Overhead.
 - b. General Overhead:
 - (1) Include only the amount of the accepted Schedule of Values, Form HUD-2328, adjusted by the effect of approved change orders.
 - (2) Itemization is not required.
 2. Kickbacks, rebates, adjustments, discounts, or any other devices which the contractor may have received or is entitled to, must be deducted from actual costs.
- B. For those cases where the mortgagor is not seeking a mortgage increase or a detailed review is not requested by the Hub Director:
1. The cost analyst will not review Form HUD-92330A, Contractor's Certificate of Actual Cost, in assisting the Mortgage Credit Examiner in the analysis of the Mortgagor's cost certification.
 2. The cost analyst will advise Mortgage Credit Examiner of the approved change orders.
- C. Cost Review
1. Conduct a detailed review when the mortgagor applies for a mortgage increase or the Hub Director orders a detailed review.
 2. Review certifications where required from the contractor, or any subcontractor, equipment lessor, material supplier or manufacturer of industrialized housing.
 3. Forms necessary to make reviews:
 - a. Form HUD-92330, Mortgagor's Certificate of Actual Cost.
 - b. Form HUD-92330-A, Contractor's Certificate of Actual Cost.
 - c. Forms FHA-3305, or 3306, Agreement and Certification (applicable to project).
 - d. Form HUD-92437, Request for Construction Changes–Project Mortgages (all approved for project).
 - e. Form HUD-92326, Project Cost Estimate (HUD Estimate).
 - f. Form HUD-2328, Contractor's and/or Mortgagor's Cost Breakdown.
 - g. Form HUD-92331-B, Cost Certification Review Worksheet.

- h. Form HUD-92331, Summary of Cost Certification Review.
 - i. Form HUD-95379, Trip Report (all for projects).
4. Steps to make review:
- a. 50/75 percent rule check (See Section 13.15.M.3): Use information from the “total” and “name of subcontractor or payee” columns of the general contractor’s cost certification. If the rule applies disallow the general contractor’s general overhead and profit. If the project uses BSPRA disallow only the general overhead and inform the Mortgage Credit Examiner.
 - b. Identity of interest subcontract review: (Mortgagor, general contractor, subcontractors, equipment lessors, material suppliers, and industrialized housing manufacturers.)
 - (1) Examine Form HUD-3305 or HUD-3306 and Form HUD-92330-A to establish all declared identities of interest.
 - (2) Review each identity of interest subcontractor’s cost certification.

NOTE: If cost certification not received, disallow subcontractor’s overhead, profit, and all questionable costs.

 - (a) If no prior approval as an identity of interest subcontractor, disallow subcontract overhead and profit.
 - (b) For prior approval:
 - (i) Allow prior approved subcontract overhead and profit, plus or minus the effect of approved change orders. Disallow excess.

NOTE: Do not reduce the prior approved subcontract overhead and profit in the event that the certified cost for the work is less than the prior approved maximum subcontract price.
 - (ii) Allow up to the prior approved maximum subcontract amount for work, plus or minus the effect of approved change orders. Disallow excess.
5. Trade line item review:
- a. On Form HUD-92331-B
 - (1) Enter all trade line costs from HUD estimate (Form HUD-93236) or Contractor’s schedule of values (Form HUD-2328) after adjusting for approved change orders.
 - (2) Enter all trade line costs from general contractor’s cost certification (Form HUD-92330-A). Take architect’s fees from mortgagor’s cost certification (Form HUD-92330).
 - (3) Using dollar and percentage variance columns compare each trade’s actual cost with the estimate. Determine allowable amounts.
 - b. Allowable amounts are not limited by the estimates. Analyze differences.

- (1) Allow actual costs paid to complete the work in accordance with the construction contract.
 - (2) Allow actual costs due to unusual circumstances, e.g., subcontractor bankruptcy, code changes, required replacement of completed work, replacements due to natural occurrences (storms, floods, earthquakes, etc.).
- c. Question only amounts substantially in excess.
- (1) Contact general contractor and/or mortgagor requesting explanation or more documentation.
 - (2) Make disallowances if explanation/documentation is not received in a reasonable amount of time.
 - (3) Only the accountant may make reallocation of monies from one trade item to another.
 - (4) As a result of discussion, have the accountant amend Form HUD-92330-A and resubmit.
- d. Disallow any amount not justified or supported as being part of the construction contract work.
- e. Disallow costs for duplication of work due to contractor's error or negligence, e.g., improper placement, failure to protect, noncompliance with contract, etc.
- D. Summary of Cost Certification Review on Form HUD-92331
1. Enter all recommended disallowances.
 2. Enter summary of construction contract costs.
 3. Enter contractor's profit from mortgagor's Form HUD-92330. Add profit from all HUD approved change orders.
 4. Enter offsite costs from mortgagor's Form HUD-92330, if applicable.
 - a. Review itemized offsite breakdown.
 - b. Disallow any cost duplication on general contractor's Form HUD-92330-A.
 5. Property Insurance Schedule, Form HUD-92329. Complete new form using allowed construction costs.
- E. Lump Sum Construction Contract Cost Certification
1. Review mortgagor's certification (Form HUD-92330) if requested to do so by Hub Director.
 2. Review cost certification of any subcontractor that has identity of interest with the mortgagor.

The nonprofit mortgagor will be permitted a six percent return on its initial equity as computed on Form HUD-2580, Maximum Insurable Mortgage.

A. It is determined as follows:

1. New Construction: Line 6, Form HUD-92580, minus finally endorsed mortgage determined in line 10 of the form.
2. Rehabilitation–Property Owned: Reduce the sum of line 4, Form HUD-92580, plus HUD’s estimate of the “as is value” of the existing land and improvements before rehabilitation, by the finally endorsed mortgage determined in line 10 of the form.
3. Rehabilitation–Property Acquired: Reduce the sum of line 4, Form HUD-92580, plus the lesser of HUD’s estimate of the “as-is value” of the existing land and improvements before rehabilitation or the acquisition cost of the property, by the finally endorsed mortgage determined in line 10 of the form.
4. Rehabilitation under Section 220 and 221(d): Use the New Construction formula in paragraph A.1 above.

B. The base equity computed in paragraph A.1 above may be increased by:

1. The cost of furnishing, equipment or other betterments essential to the operation of the project.
2. The nonprofit developer’s fee used to reduce the estimate closing costs of the project.
3. Grants from national, regional, and local community service organizations (non-government source).
4. Sponsor’s cash contribution for the cost of land over and above what HUD has allowed.

C. Modify the Regulatory Agreement to require the return on equity be used for:

1. Continued affordable housing initiatives; or
2. Pledged to the repayment of surplus cash or residual receipts notes given in favor of secondary financing.

D. Asset Management will monitor the nonprofit mortgagors to be certain that the return on equity is used only for permissible purposes.

E. The return on equity is paid from surplus cash/residual receipts. Any shortfall in return may be made up from surplus project funds in future years.

13.18**Determine the Mortgagor’s Initial Investment**

A. New construction and substantial rehabilitation projects under Sections 220 and 221(d): Line 6, Form HUD-92580, minus the maximum insurable mortgage determined in line 10 of this form.

B. The amount determined by above Paragraphs A may be increased by:

1. Expended working capital funds not recognized in the cost certification review.
2. Residential relocation expenses approved by the relocation specialist in excess of the amount established on Form HUD-92264, Section G, and Section O, Remarks and Conclusions.

13.19**Modified Form of Cost Certification – Section 223(f)**

- A. Complete and submit a modified form of cost certification for review 15 days before the initial/final endorsement of the loan for insurance for all projects processed pursuant to Section 223(f); except those 207/223(f) refinancing transactions where 75% or less of value is the controlling criterion. (In such case cost certification is not required.) Unlike other cost certification procedures, savings from one line item cannot offset cost overruns on another line item. As you complete the cost certification and there is a cost savings, you must recalculate the maximum insurable mortgage. Refer to Form FHA-2205-A's instructions.
 1. The mortgagor must certify to the total actual costs incurred in the acquisition or refinancing of the property. The certification must be submitted on Form FHA-2205-A, and it must be dated and signed by an authorized agent of the mortgagor.
 2. The mortgagee must submit the certification to HUD for computation of the maximum insurable mortgage and completion of Section II of Form FHA-2205-A.
 3. If, in a purchase transaction, the amount of the acquisition cost determined allowable at cost certification exceeds the estimate of value, which was determined during processing, the rent formula shall be recomputed. This re-computation may be accomplished using the allowable acquisition cost as determined by cost certification and the dollar amount of secondary financing represented by the approved promissory notes (Form HUD-92223).
- B. The mortgagor must submit a supplemental cost certification where an escrow was established at initial/final endorsement to complete non-critical repairs. In cases where the actual costs are less than estimated, you must recalculate the maximum insurable mortgage. If the maximum insurable mortgage is reduced because of the lower actual costs, the mortgagor must either:
 1. Provide the required prepayment to the mortgagee, or
 2. Have the required prepayment deducted from the repair escrow.

13.20**Mortgage Reduction after Cost Certification**

- A. The National Housing Act requires that the mortgage will not exceed the applicable percentage of actual costs. If certified actual costs are lower than original projected cost as reflected in Form HUD-92264, a reduction in mortgage may be applicable. The Agreement and Certification, Form HUD-3305 or HUD-3306, also addresses this issue and provides that where the Commissioner accepts, for cost certification, estimates of cost for any item, the later substitution of certified actual costs may require a reduction of the mortgage.
- B. Reductions of cost may arise from:

1. Refunds, rebates, or discounts.
 2. Excess of escrows over the actual costs of incomplete construction items.
 3. Refunds of deposits made by the mortgagor to prevent losses to the mortgagee from loss in connection with sale of the mortgage.
 4. Settlement of claims against bonding companies or others after project completion.
- C. At final endorsement, the mortgagor must set up a cash escrow to pay all "to be paid in cash items" identified on Form HUD-92330, Mortgagor's Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid on Form HUD-92330.
1. Reconcile the difference between:
 - a. Obligations listed on Form HUD-92023, Request for Final Endorsement of Credit Instrument or FHA-2455 (For Insurance Upon Completion Projects only), and
 - b. The "to be paid" column on Form HUD-92330 plus debts to third parties.
 2. Paid receipts must support differences and a statement from the mortgagor identifying by name and cost, those items paid in cash. The receipts and statement are affixed to Forms HUD-92023 or FHA-2455.
 3. Do not accept personal or business checks issued by the mortgagor at final endorsement as evidence of payment. Payment must be in certified or cashier checks.
 4. Prepare a new Form HUD-92331A to disallow obligations listed as "paid" or "to be paid" on Form HUD-92330, which are represented at final endorsement as paid by HUD-approved notes. Prepare a new Form HUD-92580 from the total of HUD-approved cost of revised Form HUD-92331A.
 5. Undisbursed mortgage proceeds may supplement or satisfy the cash escrow.
 6. Use Form HUD-92476-1, Escrow Agreement for Unpaid Construction Costs:
 - a. To set up the cash escrow.
 - b. Attach a detailed listing of the unpaid costs.
 7. Use Form HUD-92464, Request for Approval of Advances of Escrow Funds to disburse escrow.
 8. Escrow should be disbursed within 45 days after final endorsement. If all of the funds are not disbursed follow the procedures in Section D below.
 9. At final endorsement, if all obligations have been paid in cash, nothing else is needed.
- D. Sixty-days after final endorsement:
1. Prepare a new Form HUD-92331A. Enter under the column heading:
 - a. "2264" - the amount of each item of cost recognized from the earlier Form HUD-92331A "Allowed" column.
 - b. "2330/2330A" - the amount listed in Column C of the Mortgagor's Certificate of Actual Cost, Form HUD-92330, for each item of cost.
 - c. "Allowed" - the amounts paid in cash based on the reconciliation performed in Section B above and disbursements from the cash escrow account.

- c. "Disallowed" - the lower of the amounts previously allowed or paid in cash.
2. Compute a new Maximum Insurable Mortgage, Form HUD-92580, based on the total of the "Disallowed Column" (Form HUD-92331A). If this computation produces an amount less than the mortgage finally endorsed:
 - a. Notify the Directors of Housing Development and Management by memorandum that prepayment to the mortgage is required.
 - b. Prepayment is mandatory and is applied:
 - (1) In amounts equal to the scheduled monthly principal payments, to the extent possible.
 - (2) Any remainder goes to the Reserve for Replacements Fund.
 - c. If HUD is notified that payment has been delayed because of a dispute or litigation, retain funds to pay the amount pending resolution of the dispute.
 - d. Notify the mortgagee or escrow agent by letter of the required prepayment.
 - e. Control the remaining balance in a special account, as a reserve for unpaid construction costs from which disbursements may be made only after written consent of the Field Office.
3. The mortgagee will continue to use the existing amortization schedule for servicing the mortgage.
 - a. The prepayment is in addition to the regular monthly payments to principal.
 - b. There is no adjustment in the amount of the annual MIP due because of these mandatory prepayments.
4. The escrow requirement does not apply to funds the general contractor owes. However, the general contractor must submit a reconciliation of its "to be paid" items.

13.21**Increase in Mortgage Amount**

- A. Timing. Generally, requests for a mortgage increase should not be considered until the project is complete, cost certification has been submitted, and final endorsement will likely be achieved immediately following processing of the mortgage increase.
- B. Bases for considering a mortgage increase:
 1. Necessary changes that arise from differing site conditions (as defined in the construction contract).
 2. Compliance with local codes.
 3. Unforeseen conditions that might affect the safety and health of occupants.
 4. Betterment changes that are economically justified e.g., those that produce significant cost savings to project operation can be reflected in increased income expectancy, or enhance the security of the mortgage.

- C. Costs caused by extensions in construction time, when such extensions: are approved by HUD; justifiable under AIA General Conditions; and caused by problems beyond the contractor's control.
- D. Other costs not known at Firm Commitment resulting from requirements of local authorities and beyond the mortgagor's control.
- E. Construction (hard) cost increases caused by a natural disaster declared by Federal or State government, to the extent not covered by casualty insurance.
- F. Increased costs resulting from concealed subsurface site conditions, provided it is determined those exploratory tests during project design were sufficient and thorough and neither the architect nor engineer was at fault.
- G. Cost of substituting a general contractor when the original general contractor is terminated for cause and the surety has failed to perform.
- H. To correct a substantial HUD error in the original processing that would otherwise result in serious inequities.
- I. Any mortgage increase for an insured project must be more than 2-1/2 percent of the original mortgage and at least \$50,000.

13.22**Restrictions for Mortgage Increases**

- A. A mortgage increase may not be granted for cost overruns associated with: completion of the work in accordance with the original contract documents by the original contractor, changes made primarily for the convenience of the mortgagor or contractor, nor for the aggrandizement of the mortgagor or contractor.
- B. Cost overruns are not a basis for granting a mortgagor's request for mortgage increase nor are changes made primarily for the convenience or aggrandizement of the mortgagor or contractor.
- C. Any mortgage increase for an insured project must be more than 2-1/2 percent of the original mortgage and at least \$50,000.
- D. The increase must be supported by net income under Criterion 5 of Form HUD-92264-A.
- E. A mortgage increase may not be granted for replacing a contractor where the mortgagor sets up a "straw contractor" for purposes of BSPRA.

13.23**Processing a Mortgage Increase**

Technical processing consists of Step One through Step Four below. The four steps to processing a mortgage increase, depending on the condition being considered:

- A. Step One: Use the alternative applicable to the condition being considered:
 - 1. Alternative One. Applicable to necessary and betterment change order cost increases.

- a. Architecture and Valuation staffs review the change orders to determine eligibility for processing a mortgage increase. Architecture further reviews for the added cost.
 - b. Mortgage Credit computes the allowable costs on Form HUD-92331-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.d. Reduce this amount by the cost attributable to any change order(s) not qualifying for a mortgage increase.
 - c. The adjusted hard cost forms the basis of the mortgage increase computation
2. Alternative Two. Applicable to contract time extension soft cost increases.
- a. Mortgage Credit computes the allowable costs on Form HUD-92331A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 3 through 6.
 - b. The adjusted soft cost forms the basis of the mortgage increase computation.
3. Alternative Three. Applicable to construction contract cost increases due to a change in the contractor.
- a. A&E staff computes a new Form HUD-2328 and Form HUD-92264, Section G through Line 50.
 - b. Mortgage Credit staff computes the allowable costs of Form HUD-92331A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.c. for hard cost increases between the original contractor and the contractor completing the work, and Lines 3 through 6 for soft cost increases associated with the change in contractor.
 - c. The adjusted hard and soft costs form the basis of the mortgage increase computation.
4. Alternative Four. Applicable to substantial error in HUD cost processing.
- a. A and E staff computes a new Form HUD-2328, and Form HUD-92264, Section G through line 50.
 - b. Mortgage Credit computes the allowable costs on Form HUD-92231A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.c, using the criteria in paragraph c. below.
 - c. The allowable construction costs for processing the increase will be based upon the lesser of:
 - (1) The amount of the construction cost certified by the mortgagor, or
 - (2) The upset price of the construction contract as adjusted by approved change orders eligible for a mortgage increase, plus the increases resulting from correcting or errors in the original processing.
 - d. The adjusted hard cost forms the basis of the mortgage increase computation.
- NOTE: The mortgage credit examiner must not use the adjusted upset price of the construction contract as a limiting criterion at cost certification where there is a substantial error in HUD cost processing.

- B. Step Two: Mortgage Credit must compute (for use by Valuation in completing Form HUD-92264) the eligible costs and fees for the following: architect's fees, bond premium if paid by the mortgagor, other fees not included in the construction contract and paid by the mortgagor,

interest, taxes, insurance, developer's fee (if applicable), legal, organizational and audit fees, marketing (if applicable), offsite costs, as-is land value and "as-is" value of property (if applicable). Mortgage credit must comply with the following in computing the costs and fees.

1. Do not increase BSPRA or restore Contingency Reserve or nonprofit's Developer's Fee.
 2. Do not include non-mortgageable items (construction or permanent loan extension fees; discount rate, maintenance fees, etc.)
 3. Offset non-mortgageable items by net income (net non-proprietary income, if applicable) to offset amount of mortgage increase, and
 4. For increases caused by natural disaster:
 - a. Consider in the revised cost any increases from any interim closing for: carrying charges, financing fees, and legal fees. Do not include any cost due to construction delays before the disaster,
 - b. Cut the new estimated replacement cost by the amount of any actual recovery through insurance proceeds, and
 - c. Require prepayments to be made for any late recovery of insurance proceeds.
- C. Step Three. Valuation must use the costs and fees developed by Mortgage Credit in Step Two in revising Form HUD-92264. Valuation must consider each of the following:
1. Examination fee, initial service fee, GNMA/FNMA fee, inspection fee, MIP, and title and recording based on the approvable increased mortgage amount.
 2. Net income derived from market rent, expense and occupancy estimates current as of the date of mortgage increase processing.
- D. Step Four. Mortgage Credit must prepare a revised Form HUD-92264-A, using the revised Form HUD-92264 and Trial Form HUD-92264A prepared by Valuation in Step Three.

13.24**Authorization to Reopen Mortgage Transaction**

- A. Advise the mortgagee of HUD's approval or denial of the request for a mortgage increase upon completion of technical processing. Use Specimen Letter-Agreement Authorizing Reopening of Mortgage Transaction (Appendix 14A), to notify the mortgagee, where a determination is made to increase the mortgage.
1. Approval of a mortgage increase is subject to the payment of the following fees based on the amount of the increase.
 - a. Application Fee of \$3.00 per thousand of the increase.
 - b. Inspection Fee of \$5.00 per thousand of the increase, applicable only where the increase involves construction (hard) costs.

13.25**Deferral of Principal Payments**

The Lender must support the request for deferment of principal payments.

- A. HUD will consider Requests for Deferment if:
 - 1. There is a delay in construction; or
 - 2. The project requires additional time to reach sustaining occupancy.
- B. HUD will approve the Request when:
 - 1. There are sufficient funds outside mortgage proceeds for payment of interest overrun either by:
 - a. Written assurance from the sponsor, or
 - b. Exercise of action against the contractor.
 - 2. The mortgagor shows reasonable effort to complete construction and attain a sustaining occupancy.
- C. The Period of Deferment is the additional time necessary for the mortgagor to stabilize its operation.
- D. Deferment Letter. Use Appendix 14B, Specimen Letter – Agreement Authorizing Deferment of Principal Payments for Level Annuity Monthly Payment, and distribute copies in accordance with Section 13.26 below.
- E. Deferment Instruments. The Hub Director is authorized to approve modifications of the mortgagee instruments as may be necessary to effect the deferment of principal payments. The HUD closing attorney must clear the instruments.

13.26**Document Distribution**

- A. Form HUD-92580, Maximum Insurable Mortgage.
 - 1. Mortgagee—original and one executed copy.
 - 2. One executed copy to each of the following: Closing Attorney, Mortgage Credit Control File, Washington Docket, Field Office Docket, Field Office Valuation Data Bank.
- B. Cost Certification Documents. Original documents filed in the Washington Docket and one copy in the Field Office Docket.

13.27**Inspector General Audit**

The Hub Director should request the District Inspector General for Audit to audit the mortgagor's and/or contractor's books where apparent discrepancies appear to arise from other than inadvertent error, or creditable misinterpretation of applicable criteria. Do not issue Form HUD-92580, Maximum Insurable Mortgage, before completion of an IG Audit initiated before its issuance. An audit must also be requested for any indicated fraud or material misrepresentation detected after issuance of Form HUD-92580.

13.28**Cost Certification Incontestability**

After HUD approves the certifications, and issues Form HUD-92580, Maximum Insurable Mortgage, they are final and incontestable unless there is fraud or material misrepresentation by the mortgagor, general contractor, or subcontractors.

13.29**Post Closing Escrows**

Post Closing Escrows must be set up at final closing to pay all “to be paid in cash” items identified on Form HUD-92330, Mortgagor’s Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid on Form HUD-92330. These amounts may be adjusted for payments made between the cut-off date and the date of final closing.

CHAPTER 14

**SUMMARY OF MAJOR CHANGES IN CHAPTER 14 OF THE MAP GUIDE
LIHTC and Other Tax Credit Guidance**

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

There is a major highlights section in front of the Guide to direct/advise Field Office personnel and MAP Lenders as to the specific changes made to the Guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects), Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 14 revisions in the new release:

- This Chapter contains the 2008 HERA provisions e.g. cost certifications not being required on loans that have a loan amount to actual cost of less than 80%, establishment of LIHTC coordinators, elimination of subsidy layering review.
- The Department will no longer require a cash escrow for LIHTC equity.
- Separate Sections provide technical guidance for architectural, valuation, and mortgage credit.
- We discuss briefly the combination of historic rehabilitation tax credits with LIHTC for the rehabilitation of affordable housing.

LIHTC and other Tax Credit Guidance

14.1

Introduction

The Low Income Housing Tax Credit program was enacted as part of the Tax Reform Act of 1986. Its mission was to place affordable rental housing tax benefits in part of the tax code. This part of the tax code is Section 42 of the IRC of 1986. The objective of the program was to provide investor equity capital to reduce debt service and thereby lower rent. The Low Income Housing Tax Credit (LIHTC) program provides a dollar-for-dollar reduction in tax liability for owners. The LIHTC is a housing program in the tax code, administered by the Treasury Department and the State Housing Finance Agencies (HFA).

On July 30, 2008, the Housing and Economic Recovery Act of 2008 (HERA) became Public Law 110-289. Title VIII of HERA, in subtitle B, cited as the “Housing Tax Coordination Act of 2008,” made changes to the multifamily programs of the Federal Housing Administration (FHA) to facilitate the use of such programs with low income housing tax credits.

This chapter outlines for the MAP Lender and HUD staff the policies and procedures to follow when underwriting and reviewing all FHA insurance applications referenced under Title II of the National Housing Act with LIHTC’s. Standard processing of applications as outlined in Chapters 3, 5, 6, 7, and 8 apply except as modified below.

14.2

LIHTC Coordinators

The Headquarters Office of Multifamily Development has established a lead LIHTC Coordinator and each Hub Office and/or Multifamily Program Center has a designated LIHTC Coordinator. Below is the objective of the LIHTC Coordinators.

A. Role of the designated LIHTC Coordinator:

1. Enhance staff knowledge of the LIHTC program;
2. Expedites and coordinates the processing of FHA insurance applications with LIHTCs;
3. Markets and performs outreach of HUD’s mortgage insurance programs to industry partners;
4. Acts as local contact person regarding FHA insurance programs and LIHTC issues;
5. Increases processing consistency among HUD/PC offices; and,
6. Communicates with Headquarters regarding local issues or proposed changes to policy/procedures involving LIHTCs and HUD insurance programs.

14.3

General

A. Subsidy Layering Review (SLR)

The Housing Economic Recovery Act (HERA) of 2008 eliminated HUD's SLR requirements for multifamily projects with mortgages insured under Title II of the National Housing Act. Most of HUD's mortgage insurance programs are therefore exempt. Projects with Risk-Sharing mortgages are notable exceptions.

B. Equity Contribution

Regulation 24 CFR 200.54 states that the mortgagor is to deposit with the mortgagee an amount of "cash deemed by the Commissioner to be sufficient, when added to the proceeds of the insured mortgage, to assure project completion and pay the initial service charge, carrying charges, and legal and organizational expenses incident to the construction of the project." HERA provides that if the project is to receive the benefit of equity from Low-Income Housing Tax Credits, the Department may not require the escrowing of any of such equity, or accept any form of security in place thereof, such as a letter of credit.

While low-income housing tax credit equity will not be escrowed, an appropriate amount of tax credit equity must be invested at the time of initial endorsement to provide a reasonable degree of assurance that the relationship between the mortgagor and the tax credit investor will be maintained. We believe that an expenditure of 20 percent of the total low-income housing tax credit equity at the time of initial endorsement is sufficient to ensure the investor's continued commitment.

C. Cost Certification

The Housing Economic Recovery Act affects the mortgagor's obligation to certify "actual cost." If it is determined at the time of Firm Commitment issuance that the ratio of loan proceeds to the actual cost of the project is less than 80 percent, the mortgagor is not required to certify "actual costs" upon completion of project construction, rehabilitation or repair for mortgage insurance transactions involving low-income tax credits.

D. Previous Participation Review

For LIHTC transactions, the existing policy requires Previous Participation clearance through either the electronic Active Partner Participation System (APPS) or via paper by submission of the Form HUD-2530, to be obtained prior to the issuance of the Commitment is modified under the following two categories:

Category 1 - Previous participation reviews without critical findings that the Hub/PC has the authority to resolve and;

Category 2 - Previous participation submissions containing flags that must be resolved by HQ but that are not required to be presented to the Multifamily Participation Review Committee (MPRC). Hubs/PCs proposing to issue a Commitment under this category, must receive confirmation from the Policy and Participation Standards Division (PPSD) that a complete recommendation has been received and that a referral to the MPRC will not be made. For this category of previous participation review, the following conditions apply:

- a. Complete APPS applications or HUD-2530s for all project principals must be filed with the firm commitment application.

- b. All APPS applications or HUD-2530s requiring PPSD review must be referred to the PPSD within 3 business days of receipt of the firm commitment application from the participant. Notice of referral to PPSD in paper or in APPS must be made via email to the staff persons identified by PPSD on the day of the referral. The subject of the email must be “LIHTC Firm Commitment Condition.” PPSD will not meet its agreed upon process targets if the notice is not sent timely and the Program Center may not issue a conditioned Firm Commitment.
 - c. If filed electronically, follow the existing instructions from the HQ Office of Asset Management. If filed by paper, fax one copy of the HUD-2530 to PPSD, labeled “LIHTC-2530”; send original by express mail to PPSD.
 - d. PPSD will complete a review of either electronic or paper submissions, except those that must be reviewed by MPRC, and inform the Hub/PC of the final review decision on a 15 business day target completion track. Incomplete referral packages will be returned to the Field for correction within 5 business days. Submissions requiring MPRC review will be presented to the committee on a 60 day completion track.
 - e. PPSD will notify the Hub/PC when the HUD-2530 is cleared or that a referral will not be made to the MPRC and that the firm commitment may be conditioned.
2. Notwithstanding the issuance of the Commitment, previous participation approval must be obtained prior to and as a condition of Initial Endorsement.
 3. Firm Commitments may only be conditionally issued when the commitment processing is otherwise completed and all project principals are determined to be acceptable (i.e., mortgagor entity is sufficiently capitalized, has satisfactory experience, capacity and demonstrated track record of performance; the general contractor passes the working capital analysis and has adequately performed on other comparable projects, etc.).
 4. Hubs/PCs must assign firm commitment applications a project number upon receipt of the application from the mortgagee. The project number assignment at this stage will permit the APPS review process to commence concurrently with review of the firm commitment application.
- E. Upon issuance of the Firm Commitment by the Hub/PC Office, the firm commitment should contain the following suggested special condition language for either of the two categories listed above for which clearance is pending:

“Notwithstanding the issuance of this commitment, this commitment remains subject to, and the Commissioner’s obligations hereunder are conditioned upon the satisfactory resolution, as determined by the Commissioner, of the adverse items determined by HUD during the previous participation review process.”

14.4**Architectural**

The current policy as outlined in Chapter 5 requires the submission of complete and final architectural Drawings and Specifications with the Firm Commitment Application, however, for projects involving LIHTCs, the submission of final project drawings and specifications may be deferred until Initial Endorsement. Other modifications are as follows:

- A. Schematic drawings may be submitted in lieu of complete and final plans and specifications with the Firm Commitment application.
- B. MAP Lenders and Hub/PCs must review the level of experience of all development team members and must determine that only those with adequate knowledge of HUD's development, design and building requirements are accepted for this streamline process. Hub/PCs should also consider the complexity of the proposed design and construction when determining whether to permit the deferred submission of final drawings and specifications.
- C. Hubs and PCs should determine that the project will achieve initial closing within 60 days after issuance of a firm commitment conditioned upon final plan submission. In addition, full and final plans must be submitted 30 days prior to the scheduled initial endorsement to provide time for HUD review and approval.
- D. The Firm Commitment may be conditioned upon the timely receipt and satisfactory review of complete and final plans and specifications, subject to the conditions outlined below:

The MAP Lender's submission of less than 100% of the Drawings and Specifications (i.e., schematic/line/working drawings) must provide the following detail:

1. The static footprint of the building as it rests on the surveyed site plan.
 2. The gross building and net residential footage.
 3. Unit layouts for each major unit type.
 4. Sufficient design detail to make a Davis-Bacon Wage rate classification determination.
 5. Sufficient design detail to determine compliance with accessibility requirements found at Appendix 5 of the MAP Guide.
 6. A written cost estimate (HUD-2328) from the general contractor proposed to participate in the project.
 7. For Pre-applications - Exhibit #8 of Appendix 4A of the MAP Guide.
 8. For Firm Commitment applications: Exhibits A.16, 17, 24, 25, 27, and B.3 of Appendix 4A of the MAP Guide as applicable.
- E. Scope of HUD Review and determinations required in order to issue a Firm Commitment:
1. An assessment that the estimated project cost based on form HUD-2328 is reasonable and in line with comparable HUD LIHTC project data;
 2. An assessment that the proposed general contractor is acceptable pursuant to outstanding requirements (sufficient working capital, experience, etc.); and
 3. An assessment that the sketch plans are in compliance with all applicable requirements on a preliminary basis, with appropriately qualified certifications executed.

- F. A modification must be made to the commitment for those projects determined to be eligible for the submission of deferred plans. Below is a sample special condition to be added to the firm commitment.

“As an accommodation, this commitment has been issued and based upon schematic drawings, instead of the final drawings and specifications. At least 30 days prior to the scheduled date for initial endorsement, the Commissioner must receive the final drawings and specifications for review and approval to ensure consistency of design and cost. In the event that there is a net cumulative construction cost increase or change in the design concept, or a net cumulative construction cost decrease in the amount of more than two percent (2%), this commitment shall be subject to and conditioned upon the further approval of the Commissioner, to be evidenced in writing, and may be terminated and voided by the Commissioner, or additional conditions may be imposed, at the Commissioner’s option.”

- G. The Phase I (ASTM Practice E 1527-06 or most current) environmental report must contain no significant unresolved environmental issues that would justify a Form HUD-4128 “Environmental Assessment & Compliance Findings for the Related Laws” rejection finding.

14.5

Valuation

Standard processing of applications as outlined in Chapter 7 applies except as modified below:

- A. With the elimination of the requirement for an audited cost certification from the mortgagor for mortgages insurance transactions with LIHTC and that the ratio of loan proceeds to the actual cost of the project is less than 80 percent, the audit fee will no longer be recognized as an allowable cost in HUD’s Total Estimated Replacement Cost of Project, Section G line 66 Form HUD-92264.
- B. Rents for tax credit units are restricted by the maximum allowable rent limit. Residents may not be charged fees for facilities such as pools, parking and recreational facilities if the costs of these facilities were included in the development’s eligible basis. However, fees in addition to rent may be charged for facilities such as pools, parking and recreational facilities as long as the cost of the facilities were excluded from eligible basis. Use of the facilities must be optional and there must be a reasonable alternative available to the resident.

Examples:

If a resident is required to lease a garage, then the facility is not optional. Any such fees charged to the residents are considered rent and must comply with the maximum allowable rent limit for that tax credit unit.

If an owner offers washers and dryers in the units for an additional fee, the cost of the washers and dryers must not be included in the eligible basis and an alternative such as laundry facilities in the building must be provided to the tenants.

- C. Properties with tax credit restricted units will normally have a higher operating expense ratio per unit than market rate properties. This added expense may be due to increased administrative costs for monitoring, leasing and staffing to operate on-site amenities such as after-school day-care

facilities, computer labs for educational or employment opportunities, transportation vans and social activities for the elderly. Estimating operating expenses for projects that are to be funded through the sale of LIHTCs requires the analysis of LIHTC comparables if available, and consultation with other experts (i.e. appraisers and property managers) in the context of current market conditions and should consider the size of the project and unit mix. Utility expenses in LIHTC projects may be estimated by the analysis of actual costs supplied by the developer, the utility company, or by use of the Section 8 utility allowances.

- D. The review appraiser must ascertain that the correct income limits are employed in calculating the maximum LIHTC maximum rents and in completing the Form HUD 92264-T. The Housing Economic Recovery Act of 2008 (HERA) modifies HUD's income limit methodology for calendar years after 2008 to require the Department to increase applicable area median incomes by the amount area median incomes rise, even if the HUD-determined area median incomes would be frozen under the Department's 2007 and 2008 income limit methodology. For LIHTC, HERA defines area median income in rural areas as the greater of the area median income and the national non-metropolitan median income, effective for income determinations made after date of HERA enactment, applicable only to 9 percent Tax Credit development.
- E. The LIHTC program requires income and rent restrictions throughout the term recorded in the Extended Use Agreement or Land Use Agreement. The owner must assure occupancy restrictions remain consistent with the occupancy restrictions outlined in the application and recorded in the LIHTC Extended Use Agreement. In addition, the owner must also elect a minimum set-aside of either 20 percent of the LIHTC units will be restricted at 50 percent of median household income or 40 percent of the LIHTC units will be restricted at 60 percent of median household income.

14.6

Mortgage Credit

Standard processing of applications as outlined in Chapter 8 applies except as modified below:

A. LIHTC Equity Contribution

1. Pursuant to the Housing and Economic Recovery Act of 2008, HUD may no longer require that a mortgagor place in escrow one hundred percent (100%) of low income housing tax credit proceeds/equity (LIHTC Equity). HUD will require, however, that an appropriate amount of the LIHTC Equity be invested in the project and applied to HUD approved items at the time of Initial Endorsement. The amount deemed by the Commissioner to be sufficient for such purposes will depend on the circumstances of each transaction, but should be an amount that assures an ongoing relationship between the mortgagor and the tax credit investor (Investor).

It is recommended that the initial installment of LIHTC Equity be an amount that is equal to or exceeds twenty percent (20%) of the total LIHTC Equity that will be available for the project. **If less than 20% is proposed, the Hub/PC office must submit a recommendation to HQ for review and approval.** The Hub/PC must review the justification submitted by the MAP Lender as address in the Underwriting Summary Report as to how the lesser amount is

appropriate as an initial investment of the tax credit equity. The Hub/PC will forward a recommendation on field office letterhead to HQ, along with supporting documentation for approval of the lesser amount. An example of Form HUD-92264-A to assist with the calculation of the amount of the initial and subsequent infusions of tax credit equity follows.

2. The initial installment of LIHTC funds must be expended on the initial requisition at Initial Endorsement, since escrowing of these funds is no longer permitted by the Housing Economic and Recovery Act of 2008.
3. Example for Form HUD-92264-A.

There is no change in the computation to determine the cash requirements and/or front money escrow on Form HUD-92264-A. The calculation of the initial installment of LIHTC equity is calculated as follows:

Form HUD-92264-A Section II. Total Requirements for Settlement – Part B

1. a. Development Cost	<u>\$14,381,216</u>
1. b – c Total of lines a & b	<u>\$14,381,216</u>
2. Land Indebtedness (or cash required for acquisition)	<u>\$ 625,000</u>
3. Subtotal (lines 1c + 2)	<u>\$15,006,216</u>
4. a. Mortgage Amount	<u>\$10,935,000</u>
4. b. Home funds	<u>\$ 650,000</u>
5. Fees not to be paid in cash	<u>\$ 0</u>
6. Subtotal (lines 4a+4b+5)	<u>\$ 11,585,000</u>
7. Cash investment required (line 3 minus line 6)	<u>\$ 3,421,216</u>
8. Initial Operating Deficit	<u>\$ 488,772</u>
9. Other Cost (Bond cost \$312,617) and \$15,000	<u>\$ 327,617</u>
10. Working Capital	<u>\$ 218,700</u>
11. Other: Social Services Escrow \$55,000 + Fee \$2,066,897)	<u>\$ 2,121,897</u>
12. Total estimated cash requirement (sum of lines 7+8+9+10+11)	<u>\$ 6,578,202</u>
Front money escrow, if any (subtract line 6 from line 1)	<u>\$ 2,796,216</u>

Section III. Source of Funds to Meet Cash Requirements

A	Tax Credit Equity	<u>\$5,027,301</u>
B	Developer Funds	<u>\$1,550,901</u>
	Total available cash for project.....	<u>\$6,578,202</u>

The initial 20% calculation of the tax credit equity (**should be the same as the tax credit equity amount reflected in Criterion 11**) for mortgageable items is \$1,005,460. This is based on the mortgageable tax credit allocation of \$5,027,301 x 20% = \$1,005,460; it is not based on the total cash requirements for the project. The remaining cash requirements **not** being satisfied with Low Income Housing Tax Credits will be satisfied in accordance with outstanding instructions.

4. Subsequent Infusion of Tax Credit Proceeds

- a. The *Commitment for Insurance of Advances*, Form HUD-92432 (*Commitment*), should contain, among other special conditions, a requirement for the delivery of evidence satisfactory to HUD of an agreement that binds the Investor to timely and periodically pay to the mortgagor LIHTC equity to contribute to the completion costs, in the aggregate amounts proffered to HUD on forms HUD-2880 and HUD-92013. See the special conditions below.
- b. For instance, a contribution schedule that could be acceptable to HUD might require the 2nd installment of LIHTC Equity to be contributed at 50 percent construction completion, the 3rd installment at 75 percent construction completion, with the final infusion of LIHTC Equity required to complete construction and pay third party soft costs, exclusive of developer's fee, by 90 percent construction completion. HUD is aware that there may be LIHTC Equity pay-ins related to required reserve capitalization and/or developer's fee scheduled subsequent to construction completion and the achievement of certain Investor tax-related benchmarks established per the partnership or operating agreement controlling the mortgagor entity.
- c. After the first installment of LIHTC Equity is disbursed at Initial Endorsement, the subsequent contributions should be made at a time and in a manner during construction to ensure that the statutory limitations (HERA 80%) based on actual costs for the applicable FHA mortgage program are maintained during construction. To maintain the appropriate balance of LIHTC equity and mortgage loan proceeds, at each infusion of LIHTC equity, those funds may need to be utilized before the next disbursement of mortgage loan proceeds. In other words each infusion must be disbursed immediately.
- d. The actual amount of the initial equity investment should be reflected in the Firm Commitment as a special condition, and listed as a line item on the initial requisition, HUD Form 92403, Application for Insurance of Advance of Mortgage Proceeds, for immediate disbursement.

B. Cost Certification

1. The mortgagor's obligation under Section 227 of the National Housing Act (12 U.S.C. 1715r) to certify "actual cost" upon completion of project construction, rehabilitation or repair for mortgage insurance transactions involving Low-Income Housing Tax Credits. If the Secretary determines at the time of Firm Commitment issuance that the ratio of loan proceeds to the actual cost of such projects is less than 80 percent, the mortgagor will not be required to certify actual costs to HUD. For example, in cost programs such as 221(d)(4) and 220, when the "Maximum Insurable Mortgage" derived utilizing Form HUD 92264-A is less than 80 percent of the Total Estimated Replacement Cost of Project derived under Section G Line 74 of Form HUD-92264, the mortgagor will not be required to certify actual cost to HUD. See an example of this computation below. The exemption from cost certification requirements provided by HERA applies to applications for mortgage insurance involving Low-Income Housing Tax Credits under the following programs: Sections 213, 220, 221(d)(3), 221(d)(4), and 231.

The following example illustrates the applicability of cost certification requirements. When calculating the maximum mortgage amount the lowest controlling Criteria must be utilized.

Criterion 11 is used in the examples since it will often control as the Maximum Insurable Mortgage under LIHTC applications.

Section 221 (d)(4)
Form HUD 92264-A Criterion 11

11. Amount Based on Deduction of Grants, Loans, Tax Credits and Gifts for Mortgageable Items:

Total Project Replacement Cost (from Section G. Form HUD-92264).....	\$ 13,000,000
LIHTC's for Mortgageable Items	\$ 5,000,000
Maximum Insurable Mortgage Amount	\$ 8,000,000

$$\$ 8,000,000 / \$13,000,000 = 62\%$$

In this example a cost certification is not required under HERA for a LIHTC application. The ratio of loan proceeds to the firm commitment estimated project replacement cost is less than 80%.

2. Audit Fee

In cases that are exempt from cost certification, a Cost Certification Audit Fee, Section G line 66, on Form HUD-92264 is not applicable.

3. Substantial Completion

For projects that are exempt from providing a cost certification as outlined above, the HUD office will notify the MAP Lender of the substantial completion date when the project reaches 100% substantial completion, as deemed by the HUD Inspector's signature on the final HUD Representative's Trip Report, Form HUD-95379.

4. Operating Income During Construction

The Mortgagor must account for all operating income during construction and ending three months prior to the originally scheduled date of the first principal payment under the mortgage. Therefore, an Income and Expense Statement must be submitted covering the period from first occupancy (if occupancy occurred during construction) or from the date of substantial completion (as deemed by the HUD Inspector) up through the period ending three months prior to the date of the first principal payment under the mortgage as originally scheduled. The Statement must be submitted to HUD at least 30 days prior to the date scheduled for Final Endorsement. If the income and expense statement evidence receipt of income (excess funds) during this period, the mortgagor is required to deposit the excess funds into the Reserve Fund for Replacement account established under the Regulatory Agreement. An exception to this deposit is a Housing Finance Agency (HFA) may notify HUD that the funds must be used in another manner to be in compliance with Internal Revenue Code Section 42, low-income housing tax credit requirements.

5. Mortgage Increase

If during construction the project experiences significant cost overruns that result in the

mortgagor requesting a mortgage increase, the mortgagor will be required to justify and support such request with documentation satisfactory to HUD that provides a suitable basis for a mortgage increase.

6. Modified Form HUD-92580 – Determination of Maximum Insurable Mortgage

For those projects that are exempt from providing a cost certification, after construction completion, the Hub or PC will issue a modified HUD Form 2580 – Determination of Maximum Insurable Mortgage as illustrated below.

7. Sample Modified Form HUD-92580 - Determination Of Maximum Insurable Mortgage

- 1. (a) Original Mortgage Amount \$10,000,000.00
 (b thru e) are not applicable - *Insert N/A or cross through.*
- 2. ~~Certified Actual Cost~~ – *Strike certified actual cost and Insert Replacement Cost From Section G Line 74* \$ 13,000,000
- 3. Disallowed Cost(*Insert N/A*)..... \$ N/A
- 4. Recognized Actual Cost of Improvements ... (Sec. G Line 74) \$ 13,000,000
- 5. Land \$
- 6. TOTAL LAND AND IMPROVEMENTS \$ 13,000,000
- 7. Statutory Percentage of Total Cost (___% of item 6) \$ N/A
- 8. For Substantial Rehabilitation-Property Owned, enter the Lesser of:
 (i) \$_____existing Mortgage Indebtedness on (Land and Improvements to be Rehabilitated) or (ii) An Amount Equal To ___% of the Fair Market Value \$_____ of Land and Improvements Before (Repair or Rehabilitation) \$ N/A
- 9. TOTAL Line 7 plus line 8, (if any) \$ N/A
- 10. Maximum Insurable Mortgage in Multiples of \$100, (Item 1(a) or Item 6 whichever is the Lesser) (~~Item 1(e) or Item 9 whichever is the Lesser~~) if Grants involved see attached Sheet to this form for Reconciliation of Adjustment, if required \$10,000,000

NOTE: The Mortgage Credit Analyst should note on this Form that the project is exempt from cost certification due to the *loan* to actual cost being less than 80% as authorized under the HERA 2008. Insert the actual percentage of the loan to cost _____.

Completion of the reverse side of the Form as follows:

- Schedule 1 N/A
- Schedule 2 Disallowed Cost: N/A
- Schedule 3 Computation of Mortgagor’s Initial Equity Investment

1. Total Land and Improvements (line 6 above) \$13,000,000

2. Less: Maximum Insurable Mortgage (line 10 above) \$10,000,000
3. Mortgagor's Initial Equity Investment \$ 3,000,000

C. Special Conditions for the Firm Commitment – Form HUD-92432

1. Provide satisfactory evidence of an agreement that binds the Investor to timely and periodically pay to the mortgagor LIHTC Equity to contribute to the completion cost, in the aggregate amounts proffered to HUD on Form HUD-22880 and HUD 9-2013.
2. An equity contribution schedule acceptable to HUD must be provided prior to Initial Endorsement.
3. The Initial Equity Investment amount is \$_____. This amount must be reflected on the initial requisition (HUD Form 9-2448) and disbursed in its entirety at Initial Endorsement.
4. Subsequent LIHTC Equity contributions should be made at a time and in a manner during construction to ensure that the statutory limitations based on actual costs for the applicable FHA mortgage program are maintained during construction. To maintain the appropriate balance of LIHTC Equity and mortgage loan proceeds, at each infusion of LIHTC Equity, those funds may need to be utilized before the next disbursement of mortgage loan proceeds.
5. Since the project is exempt from providing a cost certification, prior to Final Endorsement and when the project reaches 100% substantial completion, an income and expense statement must be submitted covering the period from first occupancy (if occupancy occurred during construction) or from the date of substantial completion (as deemed by a HUD Inspector) through the period ending three months prior to the date of the first principal payment under the mortgage, as originally scheduled. The statement must be submitted at least 30 days prior to the date scheduled for Final Endorsement. If the income and expense statement evidences receipt of income (Excess Funds) during this period, the Mortgagor will be required to deposit the Excess Funds into the Reserve Fund for Replacement established under the Regulatory Agreement unless the Housing Finance Agency has notified HUD that the funds must be used in another manner in order to be in compliance with IRC Section 42 for low-income housing tax credits.
6. If during construction the project experiences significant cost overruns that result in the mortgagor requesting a mortgage increase, the mortgagor will be required to justify and support such request with documentation satisfactory to HUD that provides a suitable basis for a mortgage increase
7. As an accommodation, this commitment has been issued and based upon schematic drawings, instead of final Drawings and Specifications. At least 30 days prior to the scheduled date for initial endorsement, the Commissioner must receive the final Drawings and Specifications for review and approval to ensure consistency of design and cost. In the event that there is a net cumulative construction cost increase or change in the design concept, or a net cumulative

construction cost decrease in the amount of more than two percent (2%), this commitment shall be subject to and conditioned upon further approval of the Commissioner, to be evidenced in writing, and may be terminated and voided by the Commissioner, or additional conditions may be imposed, at the Commissioner's option.

8. Notwithstanding the issuance of this commitment, this commitment remains subject to, and the Commissioner's obligations hereunder are conditioned upon the satisfactory resolution, as determined by the Commissioner, of the adverse items determined by HUD during the HUD-Previous Participation Review process.

14.7

Historic Rehabilitation Tax Credits

A. Historic Rehabilitation Tax Credits

The Tax Reform Act of 1986 established a 20 percent tax credit for the substantial, certified rehabilitation of certified historic structures. A certified historic structure must be listed individually in the National Register of Historic Places or be determined to contribute to a Registered Historic District. The rehabilitation tax credit is based upon the amount of qualified rehabilitation expenditures. Historic Rehabilitation Tax Credits may be combined with LIHTC for the rehabilitation of affordable housing. The rehabilitation tax credit is subject to recapture during the first five-year period commencing on the date the building is placed in service. Several States administer their own State Historic Rehabilitation Tax Credit program which may be combined with the Federal Historic Rehabilitation Tax Credit program and/or the LIHTC program. (See the applicable State's website for guidelines and/requirements for the State Historic Rehabilitation Tax Credit Program).

CHAPTER 15**SUMMARY OF MAJOR CHANGES IN CHAPTER 15 OF THE MAP GUIDE****Quality Assurance Enforcement Actions**

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

There is a major highlights section in front of the Guide to direct/advise Field Office personnel and MAP Lenders as to the specific changes made to the Guide.

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects), Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008.

Specific Chapter 15 revisions in the new release:

- Section 15.2B removed recommendation of MAP Lender Review Board for Program Center Director.
- Section 15.4 replaced the referral to the MAP Lender Review Board to the Director of MF Development.
- Removed all references to Chapter 2 because the guidance is contained herein; and all references to Section 232 program, which was transferred to the Office of Insured Health Care.
- Section 15.9.B.6 clarifies the duration or provisions modified in settlement agreements.

Chapter 15

Quality Assurance Enforcement Actions

15.1**Sanctions of a Map Lender:**

Overview

By permitting a MAP Lender to prepare much of the documentation for a loan submission for mortgage insurance, HUD places confidence in the Lender's integrity and competence. HUD and MAP Lenders have a mutual interest in ensuring consistent Lender competence and compliance with the MAP Guide and other relevant guidance and handbooks. If in the process of performing this work, the Lender places HUD at risk, HUD needs to issue a Warning Letter or sanction to the Lender as quickly as possible.

Every HUD multifamily employee plays an important role in the MAP Quality Assurance (QA) effort. This Chapter provides QA guidance to Program Centers, Hubs, and the Office of Multifamily Development (OMD) including the Lender Qualifications and Monitoring Division (LQMD), regarding QA tools: i) Warning Letters; ii) Probation; iii) Suspension; iv) Termination; v) Limited Denial of Participation (LDP); and vi) referral to the Mortgagee Review Board or the Office of Inspector General. An LDP is a sanction applied to participants in loan transactions other than FHA-insured lenders; the procedures governing LDP are set forth in 24 CFR § 24.700, *et seq.* The purpose and authority of the Mortgagee Review Board is set forth in 24 CFR Part 25.

15.2**Authority to Issue MAP Underwriting Sanctions**

A. General.

1. At any time, a Hub/Program Center Director or the Director of the Office of Multifamily Development (OMD) may initiate discussion with a MAP Lender regarding any concerns HUD has with respect to any of the Lender's actions or personnel, or any changes the Lender should make using its MAP authority. In this connection, HUD employees are reminded of the Department's policy on use of electronic mail contained in HUD Administrative Handbook 2400.1, Chapter 7.
2. If there are concerns about the Lender's underwriting and/or construction loan administration, a Hub/Program Center Director, or the Director of OMD may take certain actions as detailed below.
3. Every HUD multifamily employee is required to refer possible instances of fraud, material misrepresentation or other criminal violations to the Office of the Inspector General.

B. A Program Center Director may:

1. Issue a Warning Letter to the MAP Lender.
 2. Recommend to the Hub Director that s/he recommends to the Director of OMD the Suspension or Termination of MAP privileges.
 3. Initiate the issuance of a Limited Denial of Participation (LDP) of an individual or Firm involved in a “covered transaction” as defined in 24 CFR 24.110.
- C. A Hub Director may:
1. Issue a Warning Letter to the MAP Lender.
 2. Initiate the issuance of an LDP of an individual or firm involved in a “covered transaction” as defined in 24 CFR 24.110.
 3. Recommend to the Director of OMD that a MAP Lender be place on probation.
 4. Recommend to the Director of OMD that a MAP Lender be referred to the Mortgagee Review Board for possible Suspension or Termination of MAP privileges.
- D. The Director of OMD may:
1. Issue a Warning Letter to the MAP Lender.
 - 2.** Refer an individual or firm involved in a “covered transaction,” as defined in 24 CFR 24.110 to the Deputy Assistant Secretary (DAS) for Multifamily Housing for imposition of an LDP in which case the LDP may be imposed on a nationwide basis or a more restricted basis.
 3. Place a Lenders MAP privileges on probation.
 4. Refer the MAP Lender to the Mortgagee Review Board.
- E. All recommendations authorized in Sections 15.2B through D above shall be in writing, and shall state the reasons for the recommendations and the facts supporting those reasons. Recommendations shall be transmitted to the next higher level of review, as set forth above, together with copies of all supporting documents.

15.3

Basis for issuing a Warning Letter or Sanctioning a MAP Lender

A MAP Lender’s improper underwriting and construction loan administration may lead to a Warning Letter or other sanction from HUD. Examples include, **but are not limited to**, the following:

- A.** Minor offenses that may be the basis for a Warning Letter include:
1. Failure to provide required exhibits or the submission of incomplete or inaccurate exhibits. Although the MAP Lender will be permitted to correct minor errors or provide additional information, substantial inaccuracies or lack of significant information will result in a return of the application and retention of any fee collected.

2. Repeated failure to complete processing to Firm Commitment unrelated to an underwriting analysis, which demonstrates that the process should not proceed to firm Commitment.
3. Preparation of an underwriting summary that is not supported by the appropriate documentation and analysis.
4. Failure to notify the HUD processing office promptly of changes in the mortgage loan application for a Firm Commitment submitted, such as changes in rents, numbers of units, or gross project area.
5. Failure to meet MAP closing requirements or construction loan administration requirements.
6. Business practices that do not conform to those generally accepted by prudent lenders or that show irresponsibility.
7. Failure to cooperate with a Lender Qualifications and Monitoring Division review.

B. Serious offenses that might be a basis for a Warning Letter and/or Probation include:

1. Receipt of multiple Warning Letters over any one-year period. In determining which sanctions to pursue as a result of a prior warning letter, HUD will consider the facts and circumstances surrounding those warning letters and the corrective actions, if any, undertaken by the Lender.
2. Fraud or material misrepresentation in the Lender's participation in FHA multifamily programs.
3. Lender collusion with or influence upon Third Party Contractors to modify reports affecting the Contractor's independent evaluation.
4. A violation of MAP procedures by a Third Party Contractor, which the MAP Lender knew, or should have known, was occurring and which, if performed by the MAP Lender itself, would constitute a ground for a sanction under this chapter.
5. Evidence that a Lender's inadequate or inaccurate underwriting was a cause for assignment of an FHA-insured mortgage and claim for insurance benefits to HUD.
6. Identity-of-interest violations under Section 2.5 of the MAP Guide.
7. Payment by or receipt of a payment by a MAP Lender of any kickback or other consideration, directly or indirectly, which would affect the Lender's independent evaluation, or represent a conflict of interest, in connection with any FHA-insured mortgage transaction.
8. Failure to comply with any agreement, certification, undertaking, or condition of approval listed in a MAP Lender's application for approval.
9. Noncompliance with any requirement or directive of the Director of OMD
10. Violation of the requirements of any contract with HUD or violation of the requirements in any statute, regulation, handbook, notice, mortgagee letter, or other written rule or instruction including the MAP Guide as interpreted by answers to Frequently Asked Questions (FAQ's) that are posted on the Multifamily MAP website.

11. Submission of false information, or a false certification, to HUD in connection with any MAP mortgage transaction.
 12. Failure of a MAP Lender to respond in a timely manner to inquiries from the Director, OMD in accordance with this Chapter.
 13. Indictment or conviction of a MAP Lender or any of its officers, directors, principals or employees for an offense that reflects on the responsibility, integrity, or ability of the Lender to participate in the MAP initiative.
 14. Employing or retaining an officer, partner, director, or principal at the time when the person was suspended, debarred, ineligible, or subject to a Limited Denial of Participation (LDP) under 24 CFR Part 24, or otherwise prohibited from participation in HUD programs, when the MAP Lender knew or should have known of the prohibition.
 15. Employing or retaining an employee who is not an officer, partner, director or principal, and who is or will be working on HUD-FHA program matters, at a time when that person was suspended, debarred, ineligible, or subject to a Limited Denial of Participation under 24 CFR Part 24 or otherwise prohibited from participation in HUD programs, when the MAP Lender knew or should have known of the prohibition.
 16. Failure to cooperate with an audit or investigation by the HUD Office of Inspector General or an inquiry by HUD into the conduct of the MAP Lender's FHA-insured loans.
 17. Failure to fund MAP mortgage loans or any misuse of mortgage loan proceeds.
- C. The issuance of a Warning Letter is not a prerequisite to the Suspension, or Termination of MAP privileges.

15.4

Administrative Record

When any final action is taken against a MAP Lender, an administrative record must be prepared. It should include all materials that might have influenced the decision, and not merely those relied upon in the final decision. Although not intended to be an exhaustive listing, examples of material that should be included are:

- Copies of correspondence;
- Copies of E-mails, if relied on in the decision process;
- Fax's including the FAX cover sheet and the FAX confirmation sheet;
- Application and underwriting submissions;
- Copies of appropriate sections of notices, guide books including Frequently Asked Questions (FAQ's) posted on the Multifamily web site, handbooks, regulations and statutes;
- Notes from meetings and telephone conversations; and
- Work product and recommendations from subordinates.

All the material should be placed in date order with an index cover sheet.

The term “final action” includes issuance of a Warning Letter but does not include any referral, recommendation for action, or presentation to the Director of OMD. In matters before the Director of OMD, the administrative record ordinarily will consist of the referral and the materials accompanying referrals to the Director of OMD, any written materials submitted by the Lender and any written materials submitted by the Director of OMD in response to those materials, the transcript of the informal meeting when that transcript is a part of the record, and the final decision of the Board.

Note: Intra-agency memoranda and other such records should be included, but will not be released if privileged. The administrative record in its final form as described in this Section, which shall be made available in its entirety to the Office of General Counsel, relates to and supports HUD’s final action and is not to be released to any person outside of HUD until it has been reviewed by the Office of General Counsel. All evidentiary material supporting any recommendation to the MAP Lender Review Board must be delivered to the Lender as provided in Section 15.13.A and must be included in the administrative record.

15.5

Warning Letters

- A. The Program Center Director/Hub Director or the Director of OMD, may issue a Warning Letter to a Map Lender.
- B. The Warning Letter:
 - 1. May require a meeting in the official’s office with principal owners of, and/or Officers of the MAP Lender to discuss the problem(s) and possible corrective action(s).
 - 2. Shall specify the violation(s) for which the Warning Letter is issued. If the Warning Letter explains or interprets a section of the MAP Guide, the text of the letter (after deleting all information that might identify the MAP Lender concerned) shall be posted on the Multifamily MAP web site as a FAQ.
 - 3. Direct the taking of a corrective action.
- C. The Warning Letter does not suspend a Lender’s MAP privileges but may impose a higher level of review of the Lender’s underwriting by the Field Office and/or Headquarters.
- D. The Warning Letter must clearly state that it is a Warning Letter issued pursuant to this Chapter of the MAP Guide. The letter is mailed to:
 - 1. The MAP Lender’s contact person as listed on the Multifamily MAP website.
 - 2. The Director, Lender Qualifications and Monitoring Division (LQMD), Room 6138, Headquarters along with a copy of the administrative record.
- E. The Lender must be sent, along with each Warning Letter, a copy of the administrative record

prepared with respect to that letter.

15.6

MAP Probation

Only the Director, OMD may place a Lender on probation. Probation is intended to be corrective in nature and not punitive. As a result, release from probation is conditioned upon the Lender meeting a specific requirement or requirements, such as replacement of a staff member.

- A. During the probation period a MAP Lender may:
1. Not submit, and the HUD Field Office may not accept, materials after the close of business of the date of the probation letter for a new:
 - a. MAP Pre-application for a Section 220, or 221(d) project involving new construction, substantial rehabilitation; or
 - b. MAP Firm commitment application for a Section 207 pursuant to Section 223(f) project involving a purchase or refinance.
- Note:** If either a new pre-application or a new firm commitment application for a Section 207 pursuant to Section 223(f) was accepted after the date of the probation letter, it shall be returned to the MAP Lender.
2. Continue to process any:
 - a. MAP Section 220 or 221(d) project involving new construction/substantial rehabilitation when a pre-application was submitted to a HUD Hub/Program Center before the date of the probation letter.
 - b. MAP Section 207 (pursuant to Section 223(f)) project involving purchase or refinance when a firm commitment application was submitted to a HUD Hub/Program Center before the date of the probation letter.
- B. Probation continues until all specific corrective actions required by the OMD (for example, exclusion of a specific staff member from work on MAP loans) are taken by the MAP Lender. At the point when all corrective actions have been taken, the MAP Lender shall notify the OMD. Once the OMD is satisfied that the corrective actions have occurred, the Probation period shall end. A false statement that corrective action has been taken constitutes a false certification as described under Section 15.3, and in addition may constitute a violation of 18 US.C. § 1001. A Lender's failure to take prompt corrective action after Probation has become final may be the basis for a recommendation to the Mortgagee Review board for either Suspension or Termination.

- C. Probation is in effect nationwide. The Lender's name shall be removed from the MAP-Approved Lender list on the web. When Probation is lifted, the Lender's name shall be re-posted promptly on the web.
- D. The probation notice is:
1. Sent by overnight delivery;
 2. Addressed to the MAP Lender's contact person as listed on the Multifamily MAP website; and
 3. Signed for by an employee of the MAP Lender upon receipt.
- E. Refer to Section 15.12 and 15.13 for sanction and notice procedures.

15.7**Suspension of MAP Privileges**

Only the Mortgagee Review Board may suspend a Lender's eligibility for MAP.

Suspension is limited by time, not to exceed 12 months except where conditions are imposed. If both a time period and conditions are imposed, a suspension shall terminate only when the time period of the Suspension expired, the MAP Lender has submitted a certification of compliance with those conditions to the Board and the Board has notified the Lender it has received the certification of compliance and is satisfied that the corrective actions have occurred.

- A. During the suspension period a MAP Lender may:
1. Not submit, and the HUD Field Office may not accept, materials after the close of business of the date of the suspension letter for a new:
 - a. MAP Pre-application for a Section 220 or 221(d) project involving new construction/substantial rehabilitation; or
 - b. MAP Firm commitment application for a Section 207 pursuant to Section 223(f)) project involving purchase or refinance.

Note: If either a new pre-application or a new firm commitment application for a Section 207 pursuant to Section 223(f) was accepted after the date of the suspension letter, it shall be returned to the MAP Lender.

2. Continue to process any:
 - a. MAP Section 220, or 221(d) project involving new construction/substantial rehabilitation when a pre-application was submitted to a HUD Hub/Program Center before the date of the suspension letter.
 - b. MAP Section 207 (pursuant to Section 223(f)) project involving purchase or refinance when a firm commitment application was submitted to a HUD Hub/Program Center before the date of the suspension letter.
- B. The suspension notice is:
 - o Sent by overnight delivery;
 - o Addressed to the MAP Lender's contact person as listed on the Multifamily MAP website; and
 - o Signed for by an employee of the MAP Lender upon receipt.
- C. Suspension is in effect nationwide. The Lender's name shall be removed from the MAP-Approved Lender list on the web. When Suspension is lifted, the Lender's name shall be re-posted promptly on the web.
- D. Refer to Sections 15.12 and 15.13 below for sanction and notice procedures.

15.8**Termination of MAP Privileges**

Only the Mortgagee Review Board may terminate a Lender's eligibility for MAP.

- A. A terminated Lender may not submit, and the HUD Field Office may not accept, materials after the close of business of the date of the termination letter for a new:
 1. MAP Pre-application for a Section 220 or 221(d) project involving new construction/substantial rehabilitation; or
 2. MAP Firm commitment application for a Section 207 pursuant to Section 223(f)) project involving purchase or refinance.
- B. Any MAP pre-application or MAP application in process may no longer be processed under MAP by the terminated Lender. The Lender will either:
 1. Immediately transfer the transaction to the Traditional Application Processing (TAP) procedure. The HUD Field Office will completely reprocess all stages of the transaction;

or

2. Immediately transfer the project to a new MAP Lender. The new MAP Lender must completely reprocess all stages of the transaction. At no time can the new MAP Lender assign the pre-application, the firm application, the mortgage insurance commitment, or the insured construction loan back to the original MAP Lender.
- C. The Department will not endorse any MAP loan processed by the terminated lender unless a firm commitment was issued before the date of termination.
1. Firm commitments involving new construction or substantial rehabilitation must be immediately transferred to a new MAP Lender. At no time can the new MAP Lender assign the firm mortgage insurance commitment, or the insured construction loan, back to the original MAP Lender.
 2. Firm commitments issued for Section 223(f) projects may be transferred before final endorsement to any approved FHA lender or kept in the Lender's portfolio.
 3. For those construction loans that have been initially endorsed, the MAP Lender will lose its MAP privileges for construction loan administration. HUD will assume all the construction loan administration duties it normally performs for TAP processing.
- D. The original Lender may service a transferred loan once it is finally endorsed.
- E. An application for reinstatement of MAP authority may not be made until at least 12 months after the date of termination. The requirements for reinstatement shall be the same as for initial qualification, and the applicant must show that the problems, which led to termination, have been resolved.
- F. The termination notice is:
- 1.** Sent by overnight delivery;
 - 2.** Addressed to the MAP Lender's contact person as listed on the Multifamily MAP website; and
 - 3.** Signed for by an employee of the MAP Lender upon receipt.
- G. Termination is in effect nationwide. The Lender's name shall be removed from the MAP-Approved Lender list on the web.
- H. Refer to Sections 15.12 and 15.13 below for sanction and notice procedures.

15.9**Settlement Agreements**

- A. The Director of OMD is authorized on behalf of the Office of Multifamily Housing to negotiate settlement agreements with MAP Lenders.
1. **Before** the Director of OMD has recommended a MAP Lender to the Mortgagee Review Board for possible Suspension or Termination, the DAS for Multifamily Housing or his/her designee must approve any proposed settlement agreement.
 2. **After** the Director of OMD has recommended a MAP Lender to the MAP Lender Review Board for possible Suspension, or Termination, only the DAS for Multifamily Housing or his/her designee may approve any proposed settlement agreement.
- B. Settlement agreements may provide for:
1. Cessation of any violation.
 2. Correction or mitigation of the effects of any violation.
 3. Removal of Lender staff from positions involving origination, underwriting and/or construction loan administration.
 4. Actions to collect sums of money wrongfully or incorrectly paid by the MAP Lender to a third party.
 5. Implementing or revision of a Quality Control Plan or other corrective measure acceptable to HUD.
 6. Modification of the duration or provisions of any administrative sanctions deemed appropriate.
- C. A MAP Lender's compliance with a settlement agreement is evidenced by the Lender certifying its compliance with the conditions of the agreement and HUD's determination that the Lender is in compliance with the conditions of the agreement.
- D. Failure by a MAP Lender to comply with a settlement agreement may result in referral to the Mortgagee Review Board for suspension or termination.

15.10**MAP Lender Review Board**

- A. The Board is authorized to take action against any MAP Lender that violates MAP requirements
- B. Composition.
 - 1. The Board shall consist of three HUD Multifamily Housing Officials designated by the Deputy Assistant Secretary (DAS) for Multifamily Housing.
 - 2. Board Members
 - a. Are selected from among Hub and Program Center Directors or Multifamily Housing employees.
 - b. May serve on a continuing basis or may be chosen for the particular review, as the DAS for Multifamily Housing determines.
 - c. Shall no prior business affiliation or other conflicts of interest with the Lender under review.
 - d. Shall select one of their members to act as Chairman of the MAP Lender Review Board.
 - e. Are expected to have a good knowledge of multifamily housing origination, underwriting and construction loan administration procedures.
 - 3. The following individuals cannot serve on the Board:
 - a. The Hub/Program Center Director making the recommendation;
 - b. Staff from the Hub/Program Center making the recommendation;
 - c. The Director of OMD; and
 - d. Staff from OMD
- C. Non-voting Advisors to the Board.
 - 1. Designee of the Office of Inspector General
 - 2. Designee of the Office of General Counsel
- D. The Director of OMD or his/her designee presents the cases to the MAP Lender Review Board
- E. Functions, Duties and Powers.
 - 1. The MAP Lender Review Board is authorized to impose appropriate sanctions on a MAP Lender after:
 - a. Conducting an impartial review of all information and documentation submitted to the board; and
 - b. Making factual determinations that there has been a violation of MAP requirements.
 - 2. In determining what action is appropriate, the Board considers among other factors:
 - a. The seriousness and extent of the violation(s);
 - b. Any history of prior offenses;
 - c. Deterrence of future violations;
 - d. Any inappropriate benefits received by the MAP Lender;

- e. Potential inappropriate benefit to other persons; and
 - f. Any mitigating factors.
3. The Board may refer:
- a. A MAP Lender to:
 - (1) The Mortgagee Review Board for possible termination as a HUD-FHA approved mortgagee or lender, and/or imposition of civil money penalties for knowing and material violations of HUD-FHA requirements. (See Section 15.17 below)
 - (2) The Office of Inspector General
 - b. An individual or firm involved in a “covered transaction,” as defined in 24 CFR 24.110 to the DAS for Multifamily Housing for imposition of an LDP in which case the LDP may be imposed on a nationwide basis or a more restricted basis.

15.11**Support Staff for MAP Lender Review Board**

- A. The Chairman of the Board supplies the clerical staff for the MAP Lender Review Board. The clerical staff:
- 1. Coordinates Board activities with other HUD offices and government agencies.
 - 2. Develops the agenda and policy issues for Board meetings.
 - 3. Notifies a MAP Lender of any sanction imposed by the Board.
 - 4. Notifies a MAP Lender, when the Board is to consider sanctions.
 - 5. Keeps the official minutes of the Board and the case files and all Board actions.
 - 6. Drafts all notices, orders, letters, and directives on behalf of the Board.
 - 7. Performs other duties assigned by the Chairman or as directed by the Board.
- B. The Office of Multifamily Development staff serves the MAP Lender Review Board as the prosecutor. The Office:
- 1. Is the contact point within HUD for Headquarters and Field Offices on all matters concerning the Board.
 - 2. Presents the sanction cases to the Board.
 - 3. Collects, analyzes, prepares and submits to the Board the charging document and supporting documentation together with possible options or recommendations as to sanctions against a MAP Lender.
 - 4. Refers cases for Board consideration.
 - 5. Negotiates settlement agreements with MAP Lenders.
 - 6. Prepares the administrative record of all matters before the Board.
- C. Office of Inspector General

1. Refers MAP Lenders for Board consideration as a result of audits or investigations.
 2. Performs audits or investigations of approved MAP Lenders.
- D. Office of General Counsel
1. Advises the Board as to the legal sufficiency of actions it proposes to take.
 2. Assists the Board in the drafting of Board decisions and orders.
 3. Assists the Director of OMD in settlement negotiations.
 4. Provides other legal advice as requested by the Board.

15.12**Procedures for Sanctions**

- A. Requests for MAP Lender Review Board Action. The Director of OMD, or his/her designee, may refer a MAP Lender to the Board for consideration of sanctions.
1. Any referral from a Hub Director must be sent to the Director of OMD.
 2. The referral must contain a written report, which includes:
 - a. A full factual background description of the violations;
 - b. Specific citations of the Department's requirements that have been violated; and
 - c. All available supporting documentation that bears upon the violations (the administrative record discussed earlier)
 3. There is no notification to the Lender until the Board is constituted and receives the charging documents from the Director of OMD. (At that point, notification under Section 15.13 is automatic, and does not require substantive consideration by the Board of the nature of the charge.)
- B. Appointment of the Board
- When the Director of OMD intends to send a referral to the MAP Lender Review Board, s/he requests the DAS for Multifamily Housing to appoint a Board, as described in Section 15.10 above.
- C. Initial Consideration by the Board
- When the Board receives a referral from the Director of OMD, the Board members may confer by email or by conference calls (telephone or video), or may meet in person. Any record of confidential communications between and among Board members at this stage of the proceedings is privileged from disclosure and will not be regarded as a part of the administrative record of any matter.
- D. Informal Conference
1. The Lender may respond and/or exercise its right to an informal conference as discussed in Section 15.13 below. The Board will schedule the informal conference, if one is requested.
 2. After notifying the Lender and permitting the Lender an opportunity to respond (as set forth more fully below), the Board will meet with the Lender or its designees (unless the Lender declines to be represented at the meeting) and with the Director of OMD and his/her designees to

review documentary evidence and presentations by both sides. (See 15.13 below)

a. Transcript of the informal meeting.

- (1) No transcript of this informal meeting will be made, unless the Lender elects to have a transcript made by a certified court reporter at its own expense. If the Lender elects to have a transcript made, it must provide three copies of the transcript to HUD within five business days of the informal meeting. The transcript will not become a part of the record unless it is submitted within the 5-day time frame.
- (2) If a transcript is not provided within the time limit set forth above, oral statements made at the informal meeting will not be considered as part of the record, except that the Board may consider voluntary admissions, made by a representative of the Lender, of any element of the violation charged.

b. Any additional documents, evidence, or written arguments, which the Lender wishes to present to the Board, must be presented within five working days after this informal meeting.

E. Action by the Board.

1. Upon consideration of evidence submitted by the Director of OMD and the MAP Lender, the Board will confer and make a final decision regarding the matter.
2. Any final decision by the MAP Lender Review Board placing a Lender on Probation, or Suspension, or Terminating a Lender shall be in writing and shall state the reasons for the decision and the facts supporting those reasons. Higher level officials and decision makers, including the MAP Lender Review Board, are not bound by the recommendations from other HUD officials described above, except that the Board may not take any action against a Lender which is more severe than the action recommended by the Director, OMD. In any case where the action taken or the recommendation made differs from the recommendation received, that difference shall be explained in writing.

F. Effective Date of Action.

Unless the Board decrees that a later date should apply, any sanction (probation, suspension or termination) shall become effective on the date of the Notice of Action to the Lender.

G. The Lender may appeal the Board's decision to the DAS for Multifamily Housing or his/her designee, as specified in Section 15.14 below.

15.13**Notice of Violation**

A. Before the MAP Lender Review Board reviews a matter for consideration of a sanction, the Board's Chairman will issue written notice of the proposed action to the MAP Lender's contact person as listed on the Multifamily MAP web site. The notice is sent by overnight delivery and must be signed for by an employee of the MAP Lender upon receipt. The notice:

1. Informs the Lender that the Board is considering a specific violation.

2. States the specific alleged factual violations with citation to the Department's requirements that have been violated.
3. Includes as attachments copies of all documents evidencing the violation or upon which the Board will be asked to rely in reaching a decision.
4. Provides the Lender with the opportunity, within 15 business days from the date of the issuance of the proposed action, to:
 - a. Meet informally with the Board in person or by video conference using HUD facilities at Headquarters or one of the various Field Offices; and/or
 - b. Present written evidence and any other relevant information.
5. Offers the MAP Lender the opportunity to reply in writing to the Board within 15 business days from the date of the issuance of the proposed action. Failure to reply may result in a determination by the Board without considering the MAP Lender's comments.
6. Requires the response to be addressed to the Chairman of the Board. The response may not exceed 15 double-spaced typewritten pages and must include an executive summary, a statement of the facts, an argument and a conclusion. All written material and supporting documentation must be submitted in triplicate.

Accompanying the notice of violation is a copy of the charging document and all of the supporting documentation that has been submitted to the Board.

- B. The MAP Lender Review Board has the power to issue a Notice of Action discussed in 15.14 below to terminate a Lender, or to place a Lender on probation or suspension without advance notice to the Lender when there is an imminent need to protect the financial interests of the Government. No such action shall be taken except upon the written recommendation of the Director of OMD and upon a determination by the Board that immediate action is necessary. In every such case, the Lender shall be promptly notified of the Board's decision and the reasons for it, and shall have the right to submit materials to the Board and appear before the Board to seek a prompt reconsideration of the Board's decision.

15.14

Notice of Action

- A. A prompt decision is important when the OMD acts to place a MAP Lender on probation. The Director, OMD will issue its final decision within 10 business days of the receipt of the Lender's information and/or the informal conference.
- B. The OMD will notify the MAP Lender of its final determination by overnight delivery of a written notice of the final decision to the MAP Lender's contact person as listed on the Multifamily MAP web site.
- C. The final decision will:
 1. State the nature and duration of the action.
 2. State the violations and any factual findings.

3. Inform the MAP Lender of its right to an appeal conference.
 4. May add or modify the reasons for the decision as stated in the initial notice.
- D. A copy of the administrative record will be sent to the Lender by overnight express within one business day after the issuance of the final decision.

15.15**Appeals**

- A. Appeal Conference.
1. Whenever the OMD imposes a sanction of probation, suspension or termination against a MAP Lender, the Lender may request in writing, an appeal conference before the appeals official. Appeals Official must be an individual who has not previously involved with the proceedings or settlement discussions up to this point.
 2. No transcript of this the appeal conference-will be made, unless the Lender elects to have a transcript made by a certified court reporter at its own expense. If the Lender elects to have a transcript made, it must provide three copies of the transcript to HUD within five business days of the informal meeting.
 3. Oral statements made by any participant at this meeting are not considered as evidence on any matter under consideration, except that the Appeals Official may consider voluntary admissions by a representative of the Lender of any element of the violation charged.
 4. Any additional written arguments, which the Lender wishes to present to the Appeals Official, must be presented within five business days after the date of the appeal conference.
- B. The appeal conference regarding the Board's action will be held within 10 business days of HUD receiving the MAP Lender's appeal request.
1. The Director of OMD provides the administrative record to the Appeals Official and points out the evidence on which the decision was made; and
 2. The MAP Lender may provide oral arguments in support of its position and the evidence previously submitted. No new evidence may be submitted to the Appeals Official at this point.
- C. A MAP Lender may voluntarily request and the Appeals Official may agree to have an appeal conference held more than 10 but not more than 30 business days after the date of the lender's request for an appeal.

- D. Within 10 business days after the date of the appeal conference, or the expiration of the period allowed for the submission of documents and written arguments, whichever is later, the Appeals Official makes a written determination. S/he may confirm, modify, or overturn the MAP Lender Review Board's decision.
- E. If the MAP Lender does not request a conference within 10 business days of receiving the sanction letter, the right to a conference will be considered waived.
- F. If the Appeals Official overturns the MAP Lender Review Board's decision, the Lender shall immediately return to an active status as a MAP Lender. The active status of the MAP Lender will be posted on the HUD web.
- G. Participation in the appeal process is not a prerequisite to filing of an action for judicial review under the Administrative Procedure Act.

15.16**Limited Denial of Participation**

See Chapter 4 of OGC Handbook 1300.13 REV 1, Debarment, Suspension, and Ineligibility of Participants and Contractors, and HUD Regulations at 24 CFR 24 Subpart G. In case of any conflict between this section and the foregoing authorities, those authorities control.

- A. Who can an LDP be imposed upon?
An LDP may be imposed upon any participant or contractor and its affiliates, except HUD-FHA approved mortgagees. Examples of participants that may be sanctioned are (but are not limited to):
 1. Independent Fee Appraisers
 2. Third Party Cost Analysts
 3. Needs Assessors
 4. Environmental Analysts and Engineers
 5. General Contractors
 6. Architects
 7. Specific underwriters or loan analysts
 - 8.** Application Sponsors

B. Who will the LDP apply to?

Once issued, the LDP may apply to any contractor, participant or to a participating organization. For example, a specific appraiser may be issued a LDP, or an entire appraisal firm may be issued a LDP. A LDP may also apply to all affiliates of that contractor or participant at the discretion of the imposing official.

C. Conditions Warranting Referral to Headquarters Recommending Consideration for a National LDP.

Referral to Headquarters for recommendation for a National LDP shall be at the discretion of the Hub Director. When it is determined that the offense warrants such a measure, the Hub Director should forward all pertinent information along with a formal recommendation to the Deputy Assistant Secretary for Multifamily Housing for review. The recommendation should include:

1. All related processing associated with the case(s) that initiated the action.
2. A narrative summary detailing the description and nature of the alleged offense(s) committed.
3. A synopsis of the participant's historic performance in past cases dealing with the Department.
4. A recommend course of action to be taken.

D. Questions should be addressed to the Director of the Compliance Division of the Enforcement Center.

15.17**Referral to the Mortgagee Board or the Inspector General**

- A. If the Hub/Program Center Director determines that a MAP Lender's actions or failure to act appears to be a compliance matter justifying action by the Mortgagee Review Board, including possible removal of its authority to do business as an FHA Lender, s/he must bring this matter and the administrative record to the attention of the Director, Office of Multifamily Development in Headquarters. The Director will refer the matter to the Director of the Mortgagee Review Board Division in the Departmental Enforcement Center.

See Section 2-4, Requests for Mortgagee Review Board Action, HUD Handbook 4060.2 REV 2, Mortgagee Review Board, and HUD Regulations at 24 CFR 25.

- B. If the issue involves possible fraud, material misrepresentation or other criminal violations, then refer the matter to the Office of Inspector General.

See Section 3-1, Responsibilities of Departmental Management and Employees, OIG Handbook 2000.3 REV-4, Office of Inspector General Activities.

CHAPTER 16

SUMMARY OF MAJOR CHANGES IN CHAPTER 16 OF THE MAP GUIDE

Master Lease Structuring to Facilitate the use of Tax Credits

This Memorandum is intended to help reviewers understand which major issues have been addressed in the revision. **This Memo will not be published as part of the Guide.**

The MAP Guide was originally published May 2000 and updated May 15, 2002, and is available online through the multifamily internet site: <http://www.hud.gov/offices/hsg/hsgmulti.cfm>

The originally published MAP Guide is a compilation of existing HUD M/F processing Handbooks (4425.2 Rev. 2, Basic Underwriting; 4435.01 Construction & Servicing before Final Endorsement, 4445.1 Underwriting-Technical Direction for Project Mortgage Insurance, 4450.1 Rev.1 Cost Estimation for Project Mortgage Insurance, 4460.1 Rev.1 Architectural Analysis and Inspections for Project Mortgage Insurance, 4470.1 Rev 2 Mortgage Credit Analysis for Project Mortgage Insurance, 4470.2 Rev. 1 Cost Certification Guide for Mortgagors and Contractors of HUD-insured and Section 202/811 Multifamily Projects), Mortgagee Letters and HUD Notices issued prior to 2000.

The revised MAP Guide before you for review is an extension of the previously published version that has been updated through the issuance of Frequently Asked Questions, published on the multifamily internet site <http://www.hud.gov/offices/hsg/hsgmulti.cfm> through May 2007; Program changes either through Housing Notices and/or Mortgagee Letters from April 2002 through April 2010; and the Housing Economic Recovery Act (HERA) 2008. This is the inaugural appearance for Chapter 16.

Chapter 16 describes the processing procedures of FHA-insured loans with tax credits, and the application involves an ownership structure called Master Lease. Master Lease is also known as a “Sandwich Lease” or “Credit Pass Through.” It is used by developers of multifamily projects to maximize the realization of tax credit equity and distribute benefits among various investors.

Master Leases are used to maximize the benefits of the following tax credit sources: Federal Historic Tax Credits, Federal New Market Tax Credits, State Historic Tax Credits, State New Market Tax Credits, and Federal Low Income Housing Tax Credits.

This Chapter describes the general requirements for the program, the required exhibits for application submission, actions of the MAP Lender and HUD staff, waiver requirements, cost certification, final endorsement and firm commitment conditions.

Chapter 16

Master Lease Structuring to facilitate the use of Tax Credits

16.1 Introduction

The Department is continuing its effort to facilitate the use of FHA-insured loans with tax credits, by issuing a set of policies and procedures for processing applications involving the use of Master Leases. Contained herein represents the Department's policy for such applications, and the processing changes described in Chapter 14, "LIHTC and other Tax Credit Guidance," are available for use with Master Lease transactions, including historic tax credits. However, at this time there is no regulatory authority to reduce the cash escrow requirements for proceeds from the syndication of *new market tax credits*. The FHA Commissioner may receive a request from the MAP Lender to waive the reduction of new market tax credit cash escrow requirements if it is determined that doing so is in the best interest of the Department and the public.

16.2 Background

Master Leases are used to maximize the benefits of the following tax credit sources: Federal Historic Tax Credits, Federal New Market Tax Credits, State Historic Tax Credits, State New Market Tax Credits, and Federal Low Income Housing Tax Credits. Master Leases are advantageous to investors and developers participating in these programs by providing maximum leverage for project financing and premium pricing for equity while reducing the need for additional debt.

A Master Lease, also known as a Sandwich Lease or Credit Pass Through, is used by developers of multifamily projects to maximize the realization of tax credit equity and distribute benefits among various investors. Typically, these leases permit a combination of investments by one or more investors under one or more tax credit programs. The Master Lease structure differs from the more traditional ownership structure in that project assets and revenues under a Master Lease structure pass through a number of tiers and, in doing so, come under the control of entities other than the Mortgagor. HUD's goal is to allow this type of structuring without compromising appropriate regulatory oversight and controls. While complicated, these transactions must include basic obligations imposed on the Master Tenant to pay the Mortgagor/Lessor rent that equals or exceeds the amount necessary to satisfy all financial obligations required under the FHA-Insured Mortgage and to operate the property in accordance with all HUD directives, regulations and contracts. To ensure compliance with such regulatory and administrative oversight and control, in addition to the Mortgagor/Lessor, the Master Tenant and all Master Sub-lessees (not individual residential and commercial tenants) will execute HUD Regulatory Agreements and submit financial reports to HUD. See Appendix 16A for a sample Master Lease ownership structure.

The Hub and applicable Program Center (PC) will be responsible for reviewing and approving requests to utilize Master Lease ownership structures in accordance with the requirements set forth herein. Hubs and PCs may not waive any of these requirements. Any proposed waivers must be sent to Headquarters (HQ) Office of Multifamily Development, for review and approval and must include a written recommendation

from the Hub Director in the proposed project's jurisdiction.

16.3 Eligible Programs

The Department recognizes that the utilization of Master Lease structuring may provide significant additional leveraging of funds and otherwise facilitate the development of historic and affordable workforce housing. At this time, the Department is prepared to accept this type of ownership structure under the following programs:

- Section 220
- Section 221(d)(4)
- Section 223(f)
- Section 231

The Department will not accept applications with this type of ownership structure under any other program. Due to programmatic complexities, until further notice, Master Leases should not be used for projects assisted by a Section 8 housing assistance payment contract or in conjunction with a Section 236 de-coupling.

16.4 General - Programmatic Requirements

In addition to the current insurance program requirements, the following are conditions for approval of an application with a Master Lease structure:

- A. The Master Tenant and Master Sub-lessees will be single purpose entities. At this time, Statutory Trusts or Delaware Statutory Trusts are not eligible entities. The Master Tenant and Master Sub-lessees may not engage in any other businesses or activity, including the operation of any other rental project, or incur any liability or obligation except as may be permitted by HUD in connection with the project.
- B. The Master Tenant and Master Sub-lessees will execute the standard HUD regulatory agreement as amended by the applicable rider in the Regulatory Agreement(s) Form, to address various ownership and operational responsibilities with respect to the mortgaged property.
- C. The management agents at the various levels will execute HUD's management certifications. The Master Tenant and Master Sub-lessees will file management certifications and management profiles. HUD will be able to terminate a management agreement, if warranted, in accordance with the terms and conditions contained in the management certification and without Lender consent, to protect its mortgage insurance interests. The management agreements will incorporate the standard termination language required in Section 9 (a) of the management certifications.
- D. Net rentable commercial area as a percentage of gross floor area and income will be determined in accordance with Chapter 3, Section 3.4 of the MAP Guide.

- E. The Master Lease and all Sub-leases (sometimes collectively referred to herein as “Leases”) shall be subordinate to the FHA-Insured Mortgage and be subject to approval by HUD prior to execution. The Leases may not be modified or amended without the prior written consent of HUD, and they may be terminated by HUD, at HUD’s election, in the event that the FHA-Insured Mortgage is assigned to HUD. Any proposed modifications or amendments to the Lease must be reviewed and approved by the Office of Field Counsel and Mortgage Credit in the Hub or PC where the application is being reviewed. The Leases shall incorporate by reference the applicable regulatory agreement, HUD rules, regulations and directives, and contain an agreement to perform or comply with the undertakings, obligations and requirements contained therein. The Leases must include an obligation to pay all rent due under the respective lease to the mortgagee of the FHA-Insured Mortgage, as directed by HUD, in the event of a default under a document that evidences, secures or otherwise is executed in connection with the FHA-Insured Mortgage. If requested timely by Mortgagor/Lessor and included in the documentation for the transaction, HUD will agree to allow an amendment to the FHA-Insured Mortgage authorizing that notice of such default be given to the Master Tenant contemporaneously with the giving of notice to the Mortgagor/Lessor, and the acceptance of a cure of such default, during such notice period, from the Master Tenant on behalf of the Mortgagor/Lessor. Any such cure must occur prior to the assignment to HUD of the FHA-Insured Mortgage, and will be limited to one opportunity to cure during each 12 month time period.
- F. Surplus cash determinations will be made in accordance with the Regulatory Agreements and related directives based upon the mortgagor’s and each lessee’s submission of audited financial statements. Surplus cash determinations (including, without limitation, net operating income) will be made as if the entire project is owned and operated by one single purpose entity. For there to be a permitted distribution of surplus cash there cannot be any defaults then existing under the FHA-Insured Mortgage, or which through the passage of time and/or giving of notice would exist, and all parties otherwise must be in compliance with their respective Regulatory Agreement.
- G. All financial operations and reporting are governed by HUD requirements and related HUD directives, as required by 24 CFR, Part 5, Subpart H.
- H. The rent paid by the Master Tenant must equal or exceed the monthly principal and interest payments due on the insured first mortgage and all required escrows and reserves.
- I. All business agreements are to be disclosed to and are subject to approval by HUD during loan underwriting (including, for example, inter-company and intra-company loans and advances, investor or outsider loans other than the FHA-Insured Mortgage, investor controls over operations including controls or rights to control activities, actions and deliverables that affect or are linked to regulatory or contractual compliance or performance, etc.). The firm commitment will incorporate any conditions imposed by HUD with respect to such agreements.
- J. Any proposed payments (fees, income, etc.) to the Mortgagor, Master Tenant, Master Sub-lessees, syndicator and developer must be disclosed to and be subject to approval by HUD at the time of loan underwriting, and thereafter be reflected on the annual financial statement filings and on any required monthly reporting to HUD. If payments are made while any party is in non-compliance, enforcement action will be taken against all principals in the organization, subject to the notice and cure provisions in above subsection E.

Credits

- K. Any cost for oversight by the tax credit allocating agency will be paid from non-project funds, or surplus cash.
- L. Consistent with the parties' obligations under the Regulatory Agreements, all Master Leases and Master Sub-leases must prohibit assignments or subleases (except to the end-users of the commercial spaces and apartment residents), unless previously approved by HUD in writing.

16.5**Firm Commitment Exhibits and Processing**

The MAP Lender should conduct a pre-application meeting with the Hub/PC Director before the submission of a formal application for mortgage insurance. In addition to the exhibits required by MAP, the following information should be submitted with the firm commitment application to facilitate a review of each transaction:

- A. All layers of financing, applicable loan/financing documents, commitments or term sheets for all financing sources (other than the FHA-Insured Mortgage), including the loan amount and key terms. If the Mortgagor/Lessor obtains bridge loan financing which is secured by future Syndication proceeds, a letter from the lending institution is submitted which:
 - 1. Details all conditions under which the loan will be made.
 - 2. Certifies that the loan is not secured by the project and that the lending institution has no claim, and will not later assert any claim, against the mortgaged property, mortgage proceeds, any reserve or deposit made with the mortgage transaction, or against the rents or other income from the mortgaged property for payment of any part of the loan transaction.
- B. Full disclosure of the name and financial interest of:
 - 1. All principals, as defined in 24 CFR 200.215(e), of the Mortgagor, Master Tenant and Master Sub-lessees;
 - 2. The general contracting firm.
- C. Certifications are provided from the following entities, disclosing all relationships between parties to the transaction:
 - 1. All principals of the sponsor/mortgagor
 - 2. Mortgagee
 - 3. General Contractor
 - 4. Management Agent
 - 5. Syndicator
 - 6. Developer
 - 7. Master Tenant
 - 8. Master Residential Tenant
 - 9. Master Commercial Tenant
 - 10. Party making bridge loan, if any

Credits

- D. A Sources and Uses statement of total development costs and Form HUD-2880, Applicant/Recipient Disclosure/Update Report.
- E. Certifications from Mortgagor/Lessor, Master Tenant, Master Sub-lessees and investor(s) that HUD has been given full disclosure of all details of the transaction structure, including the information required in Section 16.4 above with respect to business agreements and payments.
- F. A narrative describing the lease agreements between the Mortgagor/Lessor and Master Tenant, and the Master Tenant and Master sub-lessees, detailing the collection and flow of funds from the Master Sub-lessee to the Master Tenant and from the Master Tenant to the Mortgagor/Lessor.
- G. A market study establishing demand for any proposed commercial space. The market study prepared to establish demand in conjunction with applicants' award of New Market Credits may be submitted to satisfy this requirement.
- H. Previous Participation Clearance, HUD Form 2530, for the Principals of the Mortgagor/Lessor, Master Tenant and all Master Sub-Lessees. Investors in transactions involving LIHTC may opt not to apply for participation clearance and instead file a Limited Liability Corporate Investor (LLCI) certification. For LIHTC transactions the existing HUD-2530 clearance to be obtained prior to the issuance of the Commitment is modified, and the commitments may be conditioned upon 2530 approval as outlined below.
 - 1. Two categories of HUD-2530's may qualify and permit the issuance of a commitment that is subject to the final resolution of the HUD-2530 clearance:
 - a. HUD-2530's without critical findings that the field has the authority to resolve pursuant to the Office of Multifamily Housing Programs January 17, 2007 memorandum entitled Critical Findings – Modification To Previous Participation Review and Approval Process; and
 - b. HUD 2530's containing flags that must be resolved by HQ, but that are not required to be presented to the Multifamily Participation Review Committee (MPRC). Hubs/PCs proposing to issue a Commitment with this category of 2530 must receive confirmation from the Policy and Participation Standards Division (PPSD) that a complete recommendation has been received and that a referral to the MPRC will not be made. For this category of HUD 2530, the following conditions apply:
 - (1) Complete HUD-2530s for all project principals must be filed with the firm commitment application.
 - (2) All HUD-2530s requiring PPSD review must be referred to the PPSD with 3 business days of receipt of the firm commitment application from the participant. The referral package must be complete. Refer to Office of Multifamily Housing Programs, June 12, 2007 Memorandum regarding review of HUD-2530 and HUD Handbook 4065.1 for referral package instructions.
 - (3) If filed by paper, fax one copy of the HUD-2530 to PPSD, labeled "LIHTC 2530"; send original by express mail to PPSD. If filed electronically, send an email with the subject line "LIHTC-2530 to Audrey Hinton. The email must indicate which E2530 submission numbers require review.
 - (4) PPSD will place all complete submissions on a 15 business day target completion review track. Incomplete referral packages will be returned to the field for

correction within 5 business days.

- (5) PPSD will notify the Hub/PC when the HUD-2530 is cleared or that a referral will not be made to the MPRC and that the firm commitment may be conditioned.
2. Notwithstanding the issuance of the Commitment, HUD-2530 approval must be obtained prior to and as a condition of initial endorsement. Commitments may only be conditionally issued when the commitment processing is otherwise completed and all project principals are determined to be acceptable (i.e., mortgagor entity is sufficiently capitalized, has satisfactory experience, capacity and demonstrated track record of performance; the general contractor passes the working capital analysis and has adequately performed on other comparable projects, etc.).
 - I. The Mortgagor/Lessor, Master Tenant, and Master Sub-Lessees are all subject to the standard underwriting requirements found in Chapter 8 of the MAP Guide.
 - J. As with non-Master Lease applications, Initial Operating Deficit escrows (“IOD(s)”) will be required for all applications proposing a Master Lease ownership structure. For applications involving both residential and commercial components, separate IODs will be established for each. The IOD for each component will be determined based upon anticipated lease-up periods and estimated timeframes required to achieve operating income sufficient to fully satisfy all project operating expenses and mortgage obligations. This determination will be made based upon existing residential and commercial market conditions, and will be the greater of 6 months of total estimated project expenses or the amount of cash needed to reach sustaining occupancy, based on projected absorption rates, plus an additional 60 day of operating expenses.
 1. The IODs may be used to meet shortfalls experienced after commencement of amortization of the FHA-Insured Mortgage. The IODs will be maintained for the longer of 24 months after final endorsement or 3 months after the breakeven point of operations, which shall be demonstrated through the submission of certified project operating statements prorated between residential and commercial operations. The escrow of each component may be released independently if each operating statement demonstrates breakeven operations.
 2. In addition, for any IOD to be released, there must be compliance with all Regulatory Agreements, including without limitation all financial reporting requirements (e.g. audited financial statements, monthly accounting reports, etc.) and the project must have received a score of 60 or above on its most recent REAC PASS inspection. In the event that the project has not achieved a 60 or above, but has satisfied the 24 month or breakeven test, the IOD will be transferred to the project reserve for replacement account for use in addressing the project’s physical needs.

16.6

Actions Prior to Initial Endorsement

Prior to closing, HUD’s Office of General Counsel should review and approve all proposed closing documents to ensure compliance with all firm commitment obligations and Special Conditions. In addition, the following documents will be reviewed by the Hub/PC:

Credits

- A. A final detailed Sources and Uses statement of total development costs, reflecting any revisions to hard and soft costs as reflected on the firm commitment, HUD-92264. If any funding sources have changed, a revised HUD-2880 is also required.
- B. The following Forms will be revised to more clearly reflect the lease structure and HUD requirements:
 - 1. Form HUD-92433, Mortgagor's Certificate- To include language that clearly states that the Master Tenant and Sub-lessees must report lease payments during the construction period as rental income.
 - 2. Form HUD-3305, Agreement and Certification- To include language that clarifies that the Mortgagor reports all receipts and disbursements from the date of first occupancy, and that all receipts and disbursements are reported during the rehabilitation period for substantial rehabilitation cases. The Agreement and Certification will also require cost certification reporting and compliance requirements for the Master Tenant and all Sub-lessees, unless the financing includes low income housing tax credit equity and an FHA-Insured Mortgage to "actual cost" ratio of less than 80 percent.
- C. Evidence that the FHA-Insured Mortgage is in first lien position with respect to all project collateral.
- D. All documents should include conflict language giving the HUD documents supremacy over other documents. Documents may not include indemnification provisions, except as otherwise permitted by outstanding HUD guidance.
- E. At and as of closing, the Mortgagor, Master Tenant, Master Sub-lessees and investor(s) will reaffirm and certify that the information required in Section A above with respect to business agreements and payments remains true and correct. This would include any changes to disclosures of relationships discussed in Section B, as well as submission of Criminal Certificates.
- F. Each Master Lease or Master Sub-Lease (or memorandum or other notice thereof) shall be recorded in the appropriate real estate records. The Regulatory Agreement executed by each Master Tenant or Master Sub-Lessee shall likewise be recorded. These documents shall be included in Schedule B, Part II of the title insurance policy insuring the mortgage. In those jurisdictions where the recording of one or more of these documents would result in the imposition of a substantial tax, in lieu of recording the document(s) that result in the imposition of the tax, provisions shall be added to the Mortgagor's Regulatory Agreement stating that any Master Tenant and Master Sub-Lessee shall be required to execute, and be bound by, a regulatory agreement in form and substance satisfactory to HUD. Costs associated with complying with this requirement are considered a mortgageable expense.

16.7**Special Firm Commitment Conditions**

The Commitment should be annotated to reflect these special Firm Commitment conditions:

- A. The policies and procedures involving master lease structuring to facilitate the use of tax credits are incorporated herein and made a part of this Commitment for insurance of advances, specifically including, without limitation, the terms and conditions contained in (a) Section 16.4, entitled "Programmatic Requirements," (b) Section 16.5, entitled "Firm Commitment Exhibits

and Processing,” and (c) Section 16.6 entitled “Actions Prior to Initial Endorsement, thereof. Without limiting anything contained in Chapter 16, all information submitted to HUD with the Application for Multifamily Housing Project, Form HUD-92013, to evidence the satisfaction of such terms and conditions shall be true and correct as of the date submitted, and must continue to be true and correct at the time of Initial Endorsement.

- B. This commitment is subject to, and has been issued upon the reliance of, the successful (a) allocation to the project of Low Income Housing Tax Credits, and (b) syndication of such credits, with an appropriate agreement for the timely infusion of equity there from, as proffered to HUD on Forms HUD-2880 and HUD-92013, to assure completion of the project and pay other associated and incidental costs. In addition to the standard provisions that must be included in the organizational documents for the mortgagor entity, a provision must be added that prohibits any changes to the organizational documents that affect the obligations of the tax credit investor without the written consent of the Mortgagee and HUD.
- C. Notwithstanding the issuance of this commitment, this commitment remains subject to, and the Commissioner’s obligations hereunder are conditioned upon the satisfactory resolution, as determined by the Commissioner, of the adverse items determined by HUD during the HUD-2530 review process.
- D. As an accommodation, this commitment has been issued and based upon schematic drawings, instead of the final Drawings and Specifications. At least 30 days prior to the scheduled date for initial endorsement, the Commissioner must receive the final Drawings and Specifications for review and approval to ensure consistency of design and cost. In the event that there is a net cumulative construction cost increase or change in the design concept, or a net cumulative construction cost decrease in the amount of more than (2%), this commitment shall be subject to and conditioned upon the further approval of the Commissioner, to be evidenced in writing, and may be terminated and voided by the Commissioner, or additional conditions may be imposed, at the Commissioner’s option.
- E. Prior to and as an additional condition of Final Endorsement, because the project is exempt from providing a cost certification, when the project reaches 100% substantial completion, as deemed by the HUD Inspector, the Mortgagee will be notified of the substantial completion date, and pursuant to the terms hereof, the Mortgagor must account for all operating income during construction and ending three months prior to the originally scheduled date of the first principal payment under the mortgage. An income and expense statement must be submitted covering the period from first occupancy (if occupancy occurred during construction) or from the date of substantial completion (as deemed by the HUD Inspector) up through the period ending three months before the date of the first principal payment under the mortgage as originally scheduled. The statement must be submitted to HUD, at least 30 days before the date scheduled for Final Endorsement. If the income and expense statement evidences receipt of income (Excess funds) during this period, the Mortgagor will be required to deposit the Excess funds into the reserve fund for replacement established under the Regulatory Agreement, without demand by HUD, unless the Housing Finance Agency has notified HUD that the funds must be used in another manner to be in compliance with IRC Section 42, low-income housing tax credit requirements.

Credits

The Mortgagor/Lessor, the Master Tenant and all Master Sub-lessees will be required to cost certify the actual costs of the project unless the property contains Low Income Housing Tax Credit (LIHTC) equities and has an FHA-Insured Mortgage loan to cost ratio of less than 80%. Master Lease projects containing LIHTC equities will follow procedures described in paragraph 3 of this section. For all other projects, the cost certification must contain a certification signed by an authorized agent of each entity, audited by a CPA or IPA, and contain a Schedule of Tax Credit/Syndication Proceeds that includes the following:

- The amount of syndication proceeds received from the investing partner to date.
 - Purposes for which syndication proceeds received as of the cut-off date were used.
 - Dates, terms, and conditions under which future investor contributions are to be made.
- A. Total income of the Mortgagor/Lessor, including lease payments, is recognized during the construction/rehabilitation period. In accordance with HUD Cost Certification requirements, any income received by the Mortgagor/Lessor, Master Tenant and Master Sub-lessees must be applied to reduce the FHA-Insured Mortgage amount. The Mortgagor/Lessor, Master Tenant and Master Sub-lessees are required to submit a certified operating statement which reflects the income collected and expenses incurred in accordance with the lease agreements and all documents required by HUD.
- B. A final Sources and Uses Statement is included in the cost certification report as supplemental information. The final statement shall be reviewed to determine actual sources and uses. If the statement indicates that funding sources have exceeded actual uses, a mortgage reduction shall be applied accordingly.
- C. If LIHTC are included in the project development costs and the Secretary determines at the time of Firm Commitment issuance that the ratio of loan proceeds to the actual cost of such projects is less than 80 percent, the mortgagor will not be required to certify actual costs to HUD. For example, in cost programs such as 221(d)(4) and 220, when the "Maximum Insurable Mortgage" derived utilizing Form HUD 92264-A is less than 80 percent of the Total Estimated Replacement Cost of Project derived under section G. of Form HUD-92264, the mortgagor will not be required to certify actual cost to HUD.

For projects that are exempt from providing a cost certification, when the project reaches 100% substantial completion, as deemed by the HUD Inspector, the Mortgagee will be notified of the substantial completion date.

The Mortgagor must account for all operating income during construction and ending three months prior to the originally scheduled date of the first principal payment under the mortgage. Therefore an income and expense statement must be submitted covering the period from first occupancy (if occupancy occurred during construction) or from the date of substantial completion (as deemed by the HUD Inspector) up through the period ending three months prior to the date of the first principal payment under the mortgage as originally scheduled. The statement must be submitted to HUD, at least 30 days prior to the date scheduled for Final Endorsement. If the income and expense statement evidence receipt of income (Excess Funds) during this period, the mortgagor will be required to deposit the Excess Funds into the reserve fund for replacements established under the Regulatory Agreement, unless the Housing Finance Agency has notified HUD that the funds must be used in another manner to be in compliance with IRC Section 42, low-income housing tax credit requirements.

16.9

**Multifamily Housing Hub/Program Center
(PC) Responsibilities**

The Hub/PC is responsible for reviewing the submission to ensure that all applicable conditions have been satisfied and may approve requests to utilize master lease ownership structures in accordance with the requirements of this Mortgagee Letter. Hubs and PCs may not waive any requirements of this Mortgagee Letter. Any proposed waivers must be sent to HQ's Office of Multifamily Development for review and approval and must include a recommendation from the Hub Director in the proposed project's jurisdiction.