Section II
Production

Appendix 10.2

Instructions for Approval of Initial/Interim Advances

A. Approving Initial/Interim Advances

1. Before advancing any insured mortgage proceeds, disburse other available funding sources in the following order:
    a. All funds from the cash escrow established by the Borrower for onsite construction, fees, carrying charges, and financing (front money escrow).
    b. Grant/loan proceeds furnished by a national, regional, or local community service organization or a private source.
    c. Grant/loan proceeds furnished by a government agency or instrumentality unless a pro-rata disbursement arrangement has been previously approved by the Office of Residential Care Facilities (ORCF).

2. The amount approved for a requested item cannot exceed the amount claimed by the Borrower.

3. The Lender states on the Application for Insurance of Advance of Mortgage Proceeds the cumulative total of all advances made to the Borrower, including the advance under consideration. Reconcile any discrepancies before recommending approval of the advance.

4. Lender-approved disbursement amounts shall not exceed the sum of the amounts approved:
    a. For mortgage insurance;
    b. For funding from the Borrower's cash escrow; and
    c. For funding from available grant/loan proceeds.

5. HUD recognizes that, in order to deliver documents to the investor for satisfactory receipt and delivery of the initial GNMA Construction Loan Certificate, a de minimis first draw of the loan proceeds may need to be approved for disbursement at initial closing. The disbursements must be supported by justification and found acceptable to ORCF.

B. Architect's Fees

1. The Architect's cash fee is in the Standard Form of Agreement between Owner and Architect for a Federally Funded or Federally Insured Project,

AIA Document B108.

2. If there is one agreement for both design and supervisory services, a specific dollar amount must be indicated for each service.

3. There may be separate agreements for design and for supervisory services.

4. The Architect's design cash fee may be released with the initial advance.

5. Design services provided by others as detailed in the B108 must be supported by contracts approved by HUD during commitment processing before any funds may be advanced.

6. The Mortgagor's and Architect's Certificate (HUD-92403.1), must accompany any request or partial request for advance of the design fee.

7. The Architect's supervisory cash fee is advanced based on a percentage of completion method. The maximum amount that may be approved is computed by multiplying the Architect's supervisory cash fee by the percentage of work completed and approved on the Contractor's Requisition – Project Mortgages, then deducting the total of installments previously paid.

8. There is no "holdback" applied to the disbursements approved from the Architect's Cash Fee.

C. For Insurance of Advances, the Carrying Charges, Financing, Legal, and Audit Expense must not exceed their allocations in the Building Loan Agreement. Approve items due or already paid by the Borrower which are supported by bills or paid receipts. Do not approve costs for interest, taxes and insurance incurred during early commencement/start period.

Note: At cost certification, certify to the actual cost without regard to release limitations imposed by the Building Loan Agreement during the Construction period.

1. Interest is to be advanced only when and as earned. The Lender must specify on Application for Insurance of Advance of Mortgage Proceeds, the period(s) for which interest is requested and the amount for each period.
    a. At initial closing, verify as to whether a 360 or 365-day (or 366, if leap year) factor is to be used in calculating interest. Check each interest request for accuracy based on the factor indicated, and the annual interest rate approved at Initial Closing.
    b. The Lender is prohibited from drawing down interest and refunding a portion of the money to the Borrower. Such practice constitutes a kickback and is not acceptable to HUD and will be treated as a direct mortgage reduction.

2. Taxes. In approving amounts for this line item:
    a. Do not allow amounts which accrued before Initial Closing.

b. Approve invoices which are payable during construction, even if a portion of the billing period will be after an allowable cutoff date. Necessary adjustments will be made at the time of cost certification.

3. Insurance. Allow amounts for fire, windstorm, extended coverage, liability, and other risk insurance customarily insured against in the community.
   a. Do not allow amounts which accrued before Initial Closing.
   b. Do not approve invoices/receipts for workers' compensation and/or public liability insurance which are included in the cost estimate.

4. Mortgage Insurance Premium may not exceed the amount due for 1 year.

5. Initial service charge and permanent lender fees are limited to:
   a. The actual amount paid or the amount stipulated in the Mortgagee's Certificate (HUD-2434), whichever is less.
   b. The initial service fee cannot exceed 2 percent.
   c. The combined amount may not exceed 3.5 percent of the mortgage.
   d. Note: If the 3.5 percent included in processing exceeds the financing fee charges by the mortgagee, identify the excess as restricted funds.

6. Legal fees may be allowed for:
   a. Counsel to create the Borrower entity; however, legal services for the creation of tax shelters, trusts, estate planning maneuvers, and similar efforts intended to benefit the project's principals should be excluded.
   b. Costs associated with counsel's review of initial and final closing documents.
   c. Normal interim activities in creating a project.
   d. Documented costs for items in paragraphs 6.a, b, and c above which are due and payable before or at final closing may be approved in the initial advance, provided the limitation in paragraph 6.e below is not exceeded.
   e. Seventy-five percent may be disbursed at initial closing or during construction. The remaining 25 percent may not be released before Final Closing.

   NOTE: Do not allow legal expenses connected with land acquisition, title and recording charges and/or obtaining zoning as they are reflected in the land value. Amounts included in the Maximum Insurable Loan Calculation for legal and audit expenses are not blanket allowances, but ordinarily set an upper limit on allowable amounts. Atypical fees must be borne by the Borrower, unless in an exceptionally complex case, a higher fee is proven by the Borrower to be necessary and reasonable. Detailed invoices and/or other documentation are/is required as to the reasonableness, purpose, necessity, and proper classification of all items in the category.

7. Organizational Fees:

a. The amount included in the replacement cost estimate for organizational fees is an allowance to reimburse the Borrower for costs incurred to:
    i. Initiate a project;
    ii. Organize the Borrower entity;
    iii. Organize its planning, financing and construction, and
    iv. Control and manage construction through Closing
    v. Third Party costs (Appraiser etc.)
b. Release based upon the following:
    i. Disburse 65 percent at initial closing.
    ii. Disburse 15 percent during construction based upon a percentage of completion.
    iii. Disburse the remaining 20 percent at Final Closing.

    Note: Lender's Third Party Costs, reflected in Organization Costs are exempted from the 65% rule. The rule only applies to the Borrower's organizational costs.
c. This allowance may not be used to subordinate the cash requirements for closing.
d. At cost certification allow only the amount included in the Maximum Insurable Loan Calculation for organizational fees, unless fully supporting documentation is submitted by the Borrower which justifies the need for and reasonableness of the additional expenditure. Any costs incurred in excess of this allowance are not eligible for recognition in processing a mortgage increase or the equity computation on the Maximum Insurable Loan Calculation.

8. Audit fees associated with obtaining an accountant's opinion of the Borrower's cost certification cannot be advanced until Final Closing.

9. Title and Recording. Approve amounts typically incurred for:
    a. Title search and policy at the time of Initial Closing;
    b. Recording fees at Initial Closing;
    c. Mortgage and stamp taxes;
    d. Survey recording fees;
    e. Updating title policy during construction;
    f. Final title policy and recording charges; and
    g. Legal fees actually incurred and clearly for these purposes.

** Do not fully disburse these funds at Initial Closing. Ensure that sufficient funds are maintained in the account to cover title and recording costs required at Final Closing. This may require the approval of an amount less than that requested in the initial draw.

** Do not disburse funds for title and recording cost associated with acquisition of the land or property.

** Legal, organizational, title, recording costs and taxes incurred in connection with the site purchase may be added to the cost of the land in establishing the latest arms' length purchase price.

10. Developer's fee is provided in the estimated replacement cost involving non-profit Borrowers. Part or the entire fee may be used to pay for transactional costs associated with developing the project including but not limited to:
    a. Reduction of the estimated closing costs of the project;
    b. Staff salaries;
    c. Non-profit working capital deposit;
    d. Relocation expenses;
    e. Operating deficit escrow;
    f. Financing fees over and above the 3.5 percent included in the estimated replacement cost of the project;
    g. Environment studies; and
    h. Housing Consultant services provided by either in-house staff or contractor.

11. Tap fees, soil testing and other fees. Approved disbursement must be fully supported and is not to exceed the amount estimated in the general contractor's or Borrower's list of other fees for requested items. Approve disbursement only for items actually due.

12. The contingency reserve is included in the replacement cost of substantial rehabilitation projects.
    a. Use the contingency reserve for:
        i. Unforeseen costs of necessary changes approved by ORCF.
        ii. Unanticipated soft costs associated with extension of time change orders approved by ORCF.
    b. Changes classified as betterments are ineligible for funding.

13. Third-Party Lender Expenses: Fees to be paid for third-party review costs of the Lender including but not limited to Architectural reviews, Cost reviews, appraisals, and market studies.

14. At Initial Closing, HUD fees for examination and inspection.

15. Sums allocated to acquisition cost of land or existing building.

D. Allocation of Cash Available to the Borrower:

1. Allocation of cash available to the Borrower is limited to the following items and, when applicable, should be identified in an unused column on Financial Record of Mortgage Loan Transaction:
    a. New Construction.
        i. HUD's estimate of the "as-is" value of land or the actual latest arms' length purchase price, whichever is less. The latest arms' length purchase price may include the following costs incurred in connection with the site purchase:
            1. Legal fees associated with negotiations for acquisition of land,

zoning, and examination of title on the purchase or defense of title after purchase.

2. Prepaid special assessments.
3. Interest on bridge loans to purchase property after the date of submission of the initial application for mortgage insurance.
4. Taxes.
5. Cost of improvements made to the project site by the sponsor/Borrower.

b. Cash escrow to cover offsite construction cost.
c. Cost of any demolition reflected in the Fair Market Value of Land. Payment is approved as demolition progresses.
d. Construction and/or permanent loan discounts required to be paid at initial closing.
e. Escrow to cover interest shortfall escrow, working capital deposit, initial operating deposit, nonrealty items and any permanent loan discounts not required to be paid at initial closing.
f. Remaining balance may be used to fund any approved change orders or held until Final Closing.

2. Rehabilitation of Existing Construction.
   a. HUD's estimate of the "as-is" value by market comparison or the Borrower's acquisition cost/existing indebtedness, whichever is less.
   b. Items 1a through 1f above.

E. Restricted Excess Mortgage Proceeds:

Restricted excess mortgage proceeds are those excess mortgage proceeds determined not to be available to the Borrower during construction, i.e., difference by which the HUD estimate exceeds contract amounts.

1. These funds cannot be used to satisfy any escrow requirements and must be held until Final Closing.

2. Identify these funds in an unused column of the Financial Record of Mortgage Loan Transaction as restricted funds.

F. Lender Duties for Processing the Application for Insurance of Advance of Mortgage Proceeds. The Lender must review and approve the Application for Insurance of Advance of Mortgage Proceeds conducting the following major responsibilities:

1. Reconcile any discrepancies between the cumulative total for all advances, including the advance under consideration, and conclusions reached in the processing before recommending the advance for approval.
   a. Enter any required adjustments in Column B and note, "No Adjustment Necessary, Except As Indicated," or "No Adjustment Necessary," as appropriate.

b. Enter the approved amount in the "Certificate of Mortgage Insurance" on the face of the form, and where the request is reduced; explain the disallowance on the form's reverse side.

2. Determine monthly that advances are proportionate to construction progress.
   a. Require the Lender's underwriter to advise you where advances for "soft costs", i.e., financing and carrying charges, are in excess of work progress as shown by the most current Progress Schedule accepted by the HUD and the percentage of project completion reflected on the Contractor's Requisition – Project Mortgages.
   b. Take action where the mortgage is not in balance due to the fault of the contractor.
3. Secure approval from HUD for any advance requesting release of any portion of the contractor's 10 percent holdback.

4. Maintain a record of approved disbursements on the Financial Record of Mortgage Loan Transaction.

G. Certificate of Mortgage Insurance: (Prepare when the advance is eligible for approval.)

1. The approved sum is the total for the Contractor's Requisition and other eligible line items.

2. The total approved for any item must not exceed the amount allocated to the item unless the Lender submits a written request to HUD for permission to reallocate funds between line items.

3. The sum approved for mortgage insurance is the amount approved for advance less any funds remaining in the front money escrow and any grant/loan proceeds.

4. For interim advances, the Lender is to prepare this Certificate and sign for HUD, to increase the amount of mortgage insurance.

5. After signing the Application for Insurance of Advance of Mortgage Proceeds in the space for the Authorized HUD Official, and signing the Contractor's Requisition – Project Mortgages (HUD-92448) for the Director of Housing Development, the Lender sends a PDF copy of the Application for Insurance of Advance of Mortgage Proceeds, Contractor's Requisition – Project Mortgages, Financial Record of Mortgage Loan Transaction, and supporting documentation to the HUD ORCF Construction Manager.

H. HUD Monitoring of Interim Draws. The HUD ORCF Construction Manager will monitor interim draws. If a problem is encountered during an interim draw, they will bring the problem to the Lender, and, if necessary, ORCF Management in order to:

1. Modify the next draw, or

2. Withdraw the Lender's authority to approve advances.

I. Disbursement of Grant/Loan Proceeds. Grant/loan proceeds may come either from a governmental source, i.e., Federal, State, or local government agency or instrumentality, or a nongovernmental source, e.g., a foundation.

1. General for Governmental/Nongovernmental Source Funds. The proceeds are used to fund a front money cash escrow (Maximum Insurable Loan Calculation) at initial closing, whether the funding source is a governmental or nongovernmental entity. See paragraph 2 below for additional options to a cash escrow available to governmental source entities only.
    a. Disbursement priority of grant/loan proceeds in relation to mortgage proceeds and other escrows is discussed in paragraph A.
    b. Disbursement procedures from the cash escrow are discussed in paragraph D.
    c. Release of grant/loan proceeds may not be targeted to the completion of specific onsite improvements.

2. Additional Options for Governmental Source Funds. Where the grant/loan proceeds come from a governmental source, the Borrower may use instead of a cash escrow:

    a. An unconditional irrevocable letter of credit issued by a banking institution, or
    b. An agreement entered into by HUD, the Lender, the Borrower and the governmental entity for a pro rata disbursement of the loan/grant proceeds.