Section II
Production

Chapter 10
Construction Period

10.1 Start of Construction

A. General Contractor shall provide the Lender's Pre-construction Conference Coordinator (PCCC), U.S. Department of Housing and Urban Development (HUD) Office of Residential Care Facilities (ORCF) Construction Manager (CM), HUD Labor Relations Specialist, and HUD Contract Inspector, letters indicating the date (actual date, not anticipated) of Initial Construction Start (the beginning of initial site clearing and preparation) and the date of Permanent Construction Start (permanent on-site building elements put in place, such a footings and utility lines).

B. Letters can be transmitted in PDF format, via email to all recipients.

C. As there is no HUD form for these letters, the General Contractor shall use their letterhead.

D. For Substantial Rehabilitation projects, the construction start date shall be the actual date that work begins on the project. This date shall be verified by the project architect.

E. The HUD Contract Inspector must record the date of Initial Construction Start and the date of Permanent Construction on the HUD Representative's Trip Report (HUD-95379-ORCF).

10.2 Early Start of Construction

Early Start of Construction may be authorized only in 241(a) transactions, only after a firm commitment has been issued, and only in accordance with established procedures found in Appendix 10.1. Where it occurs:

A. A Pre-construction Conference is required before the start of initial construction in accordance with Section 10.3 below;

B. Construction inspections must be done in accordance with Section 10.4 below; and

C. Authorization of any insured advances cannot occur until the endorsed instrument is recorded at Initial Closing.

10.3 Lender Duties Related to the Pre-construction Conference

A. Prior to the Pre-construction Conference

1. The lender will identify a Pre-construction Conference Coordinator (PCCC). The Lender Narrative (or for Early Start, the Memo Requesting Early Start of Construction (HUD-9442-ORCF)) will include the contact information for this person (Note: If the Originating Lender will be assigning the loan at Initial Closing, the Servicing Lender shall designate a PCCC who will coordinate and conduct the Pre-construction Conference as described below).

2. The Firm Application package or Early Start Documents will include Division 00 73 00 (Master Format 2010) of the project specifications, which includes the Supplementary Conditions of the Contract for Construction (HUD-92554-ORCF) and the preliminary Davis-Bacon wage determination. The ORCF Underwriter (UW) will forward this document and the Lender Narrative (or for Early Start, the Memo Requesting Early Start of Construction) to the HUD Regional Labor Relations Officer (RLRO)/designee. This document will include the project location, number of stories, details on commercial areas, a statement as to whether all units have both a kitchen/kitchenette and bathroom, and the contact information for the PCCC.

3. The RLRO/designee shall notify the U/W via email either confirming that the wage determination is correct, or advising that the wage determination must be changed. If a change is required, the RLRO/designee shall attach an electronic copy of the correct wage determination. Upon receipt, the U/W will email a copy to the ORCF Construction Manager (CM) and to the PCCC.

4. The wage determination is subject to modification and must be current as of the date of Initial Closing/Early Start. The PCCC shall consult with the RLRO/designee to obtain any wage determination updates for inclusion in the project specifications to be signed at the Pre-construction Conference.

5. Prior to the Pre-construction Conference, the PCCC will email the CM to request the name and contact information of the HUD Inspector.

6. The PCCC will notify via email the following Pre-construction Conference attendees of the location, date, and time of the Pre-construction Conference:
    a. Borrower Representative
    b. Borrower's Supervisory Architect
    c. General Contractor
    d. Regional Labor Relations Officer / Designee
    e. ORCF Underwriter (UW) (optional attendee)
    f. ORCF Contract Inspector

g. ORCF Account Executive (AE) (optional attendee)
h. ORCF Closing Coordinator (Closer) (optional attendee)
i. ORCF CM

If the PCCC wishes to have the meeting at the HUD office (corresponding to the date/time of the Initial Closing), they shall contact the HUD Closing Attorney to make arrangements. The HUD staff listed above shall either attend the Pre-construction Conference in person or participate via conference call. Should the RLRO/designee determine that they need to make a *separate* presentation on Davis-Bacon requirements, the RLRO/designee shall advise the PCCC.

B. The Pre-construction Conference

1. The format shall follow the Lender's Pre-construction Conference Agenda (available on the Section 232 Program website).

2. The PCCC shall include the most recent Davis-Bacon wage determination in the project specifications signed at the Pre-construction Conference. Note, if a revised Davis-Bacon wage determination is required, the change will be made via addendum requiring subsequent changes to other documents such as the Firm Commitment (Exhibit B: Index to Drawings and Specifications) and the Construction Contract, which lists the Plans and Specifications.

3. At the Pre-construction Conference, the "Suggested Format for Signature Pages: Electronic HUD Set of Plans and Specifications" (Appendix 10.5), and two (2) hardcopy sets of the plans and specifications, shall be prepared and distributed as follows:

"HUD Inspection Set" of Plans and Specifications
- Legible, half-size set of Plans, and full-size Specifications manual, annotated, "HUD Inspection Set" on each
- Both shall be signed and dated on the front sheet of the plans and cover of the specifications by the Architect, General Contractor, General Contractor's Surety (if applicable), and the Borrower
- Sent to the HUD Contract Inspector

"HUD As-Built Set" of Plans and Specifications
- Full-size set of Plans, and full-size Specifications manual, annotated, "HUD As-Built Set" on each
- Both shall be signed and dated on the front sheet of the plans and cover of the specifications by the Architect, General Contractor, General Contractor's Surety (if applicable), and the Borrower
- Given to the General Contractor
- This set is not to be used for construction purposes, but rather is red lined as any changes are made to the original documents

"HUD Master Set" of Plans and Specifications

- "HUD Master Set – Plans," cover sheet (Appendix 10.5) shall be executed, and electronically "attached" to the front of a PDF version of the Plans (Plans identical to those used for the Inspection and As-Built Sets above)
- "HUD Master Set – Specifications," cover sheet (Appendix 10.5) shall be executed, and electronically "attached" to the front of a PDF version of the Specifications (Specifications identical to those used for the Inspection and As-Built Sets above)
- PDF's shall be sent on a flash drive, CD, or DVD, to the ORCF CM

4. Early Start: If plans and specifications are complete at the time of Early Start, they will be prepared as described above. If plans and specifications are not complete at the time of Early Start, they will be required to be signed prior to Initial Closing.

C. After the Pre-construction Conference

1. The General Contractor shall notify the PCCC, Supervisory Architect, HUD Inspector, and CM of the date that construction starts. See Section 10.1.A above.

2. Within one working day following the start of construction, the PCCC shall notify the RLRO/designee, and the CM of the applicable wage determination being used for the project (attach to an email). In the event that construction did not begin within 90 days after Initial Closing, the RLRO (or his/her designee) shall determine whether the wage determination had been modified and whether any updates must be incorporated into the Construction Contract.

10.4 HUD Construction Monitoring

A. Purpose of Inspection.

1. Inspection means the periodic observations made of construction at the site of a care facility project by a HUD representative (inspector) for the purpose of protecting HUD's interests. Inspections are made to evaluate the General 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 services, and the review of inspection deliverables, are described in the applicable Construction Inspection Services Contract, administered by HUD's Office of the Chief Procurement Officer (OCPO), and managed by the assigned Government Technical Representative (GTR) and/or Government Technical Monitor (GTM).

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. Upon HUD's issuance of the Early Start of Construction approval, or Initial Closing, the ORCF CM shall transmit the following executed documents, where applicable, to the assigned HUD Contract Inspector:

1. "HUD Inspection Set" of the Plans and Specifications
2. Firm Commitment, and Amendments
3. Construction Contract
4. Owner-Architect Agreement
5. Design Architect's Certification (HUD-91124-ORCF)
6. Offsite Escrow Agreement and/or Offsite Construction Contract
7. Demolition Escrow Agreement and/or Demolition Construction Contract
8. Early Start of Construction approval, if applicable.

D. 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:

1. a minimum of two field review inspections should be made on each project to evaluate the performance of the HUD Contract Inspector. Field review inspections shall be recorded on a HUD Representative's Trip Report;
2. the HUD Contract Inspectors may be accompanied during their rounds. This method is particularly advantageous in training new inspectors;
3. construction should be field reviewed where the use of questionable methods of construction, materials, uncorrected non-compliance, or other problems are reported; and
4. Projects should be field reviewed at construction stages where problems have occurred in that jurisdiction.

10.5 Architect's Duties in Administering Construction Contract

The Architect's duties shall be in accordance with Item 6, of the Lender's Pre-construction Conference Agenda (available on the Section 232 Program website), including:

A. Provide services in accordance with the Owner-Architect Agreement.

B. Have no identity of interest with the Borrower or General Contractor. An identity of interest is defined in the Construction Contract (HUD-92442-ORCF).

C. Ensure 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 Borrower and HUD Contract Inspector.

D. Architect's supplemental instructions. The architect administering the construction contract may issue field orders using American Institute of Architects' (AIA) Document G710, Architect's Supplemental Instructions, or a similar form.

   1. Supplemental instructions must not involve a change in contract sum or contract time.

   2. Uses of supplemental instructions
      a. Directive to General 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 Field Report 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 AIA Document G711, Architect's Field Report, may be used, or a similar other format.

2. A Field Report of each visit shall 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 General 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

10.6 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 Contract Inspector to determine the adequacy of the Architect's administration. The adequacy of the Architect's administration in this context is results-oriented, meaning the construction fully complies with the contract documents; 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.

A. Deficient administration. If the Architect does not report all observed non-compliances with contract documents and unacceptable performances by the General 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 is not responsible for actual construction, construction means, methods, techniques or other related responsibilities of the General Contractor. However, the Architect must keep the Lender, Borrower and HUD informed of the progress of the work and endeavor to guard the Borrower and HUD against defects and deficiencies in the construction.

B. Reasons for termination of services. Inadequate performance, undue delay, misrepresentation, failure to act on the part of the Architect or the Architect's associates and employees, and any other material breach of Owner-Architect Agreement 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. ORCF actions. The HUD Contract 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, 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 HUD Contract Inspector, the Supervisory Architect, and the Lender should be arranged and a target date established for the Architect to obtain compliance. The CM shall inform ORCF Management 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 HUD's Office of Counsel with a copy to ORCF. All actions shall be clearly documented.

D. Request for contract termination. When compliance with the Owner-Architect Agreement cannot be obtained within thirty (30) days, ORCF Management 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 no more than 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 Borrower may pursue other legal remedies for the Architect's failure to perform, including the recovery of any monetary damages.

E. Contract termination. The Borrower will hire an independent Architect who is acceptable to all parties to continue the administration of the project construction documents. In no event will HUD or the HUD Contract Inspector does not assume the Architect's responsibilities or assume any liability for the Architect's work.

10.7 Permission to Occupy, Final Trip Report, and Warranty Inspections

A. Permission to Occupy.

Permission to Occupy – Project Mortgages (HUD-92485) must be executed by the HUD ORCF CM before the Borrower permits occupancy of any dwelling unit, care facility unit, or other project service facility.

1. 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 Borrower can occupy or utilize the identified portion of the work for its intended use.

a. Support facilities (utilities, disability access, vehicular access and parking, fire & life safety equipment, etc.) must be in place.
b. Acceptability of each unit and facility for which a Permission to Occupy is requested must be established:
    i. Property must be inspected and Permission to Occupy – Project Mortgages must be signed by the Borrower, Supervisory Architect, General Contractor, and Contract Inspector (CI).
    ii. Minor items that do not preclude occupancy are permitted but must be listed as an attachment to the Permission to Occupy – Project Mortgages.
    iii. The General Contractor is fully responsible for any incomplete or improperly performed contract work whether or not listed.

2. Documents Submission – The Lender must sign the Permission to Occupy – Project Mortgages agreeing with the request and stating that insurance risks have been covered for the project. The Borrower must include the following documents with the completed Permission to Occupy – Project Mortgages:
    a. A Certificate of Occupancy or equivalent permit from the governing municipal or other local authority for all units and facilities on the Permission to Occupy, and any other required permits or authorizations;
    b. A valid and current Certificate of Property Insurance, Certificate of Fidelity Insurance, and Certificate of Professional Liability Insurance from the Borrower's insurance company;
    c. Satisfaction of any Firm Commitment Special Conditions related to the Permission to Occupy, if applicable.

3. Partial Occupancy Approval:
    a. 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 the General Contractor's utilities, etc.;
    b. Approve a series of Permission to Occupy as units or facilities become available, e.g. individual buildings on multi-building projects, or individual floors or wings on larger buildings;
    c. Approve a single Permission to Occupy for all units where dictated by management considerations, e.g. very small projects;
    d. Discussion shall be held during the Pre-construction Conference regarding the handling of all Permission to Occupy submittals.

4. Signatures, Approval, and Permission:
    a. Permission to Occupy – Project Mortgages is signed by the Borrower, Supervisory Architect, General Contractor, and Contract Inspector (CI);
    b. Approval – The ORCF CM checks either, "as reported above," or "as modified by me," and signs and dates above "Chief Architecture and

Engineering," and "Deputy," as the Federal Housing Administration's "Authorized Agent";

c. Distribution: Lender, General Contractor, Borrower, Supervisory Architect, HUD Contract Inspector, ORCF Closer, HUD Attorney, and ORCF AE.

B. Final Construction Completion / Final Trip Report.

The Architect and Contract Inspector make the final inspection upon written request of the General Contractor.

1. The Architect determines that all punch list items have been completed unless they are beyond the control of the General Contractor. (Items of delayed completion)

2. The inspector prepares the final inspection report on HUD Representative's Trip Report. The inspector:
   a. Reports onsite construction complete though there may be items of delayed completion;
   b. Lists and describes any 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 Trip Report);
   c. Lists any offsite work and reports percentage of completion for each;
   d. Includes the following endorsements:
      i. "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.")
      ii. "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. The ORCF CM reviews the Final Trip Report, and if acceptable, signs and dates the Report, and distributes copies to: Lender, Borrower, General Contractor, Supervisory Architect, HUD Contract Inspector, ORCF Closer, HUD Attorney, ORCF AE, and HUD Labor Relations Specialist.

C. Warranty 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 one year of the date of the Final Trip Report.

1. The HUD Contract Inspector schedules warranty inspections.
   a. First must be within nine months of final completion and shall provide for inspection of the entire project.

b. Other inspections may be necessary to assure inspection of seasonal items such as heating and landscaping.
c. The last inspection 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 warranty inspection on HUD Representative's Trip Report.
    a. If work is acceptable, state, "All observable work acceptable at the time of this inspection."
    b. If unacceptable, list latent defects.
        i. Describe each item.
        ii. Recommend method of correction.
        iii. 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.

3. The ORCF CM reviews each warranty inspection, and if acceptable, signs and dates the Report, and distributes copies.

10.8 Insurance of Advances and Related Matters

A. General.
Insurance of advances is the process of releasing HUD 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 Appendix 10.2 for instructions on grants/loans and tax credits.

2. The amount of construction funds approved and advanced for insurance must be consistent with construction progress approved by the HUD Contract Inspector.

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 retainage.

5. The final amount approved for insurance must be supported by certified costs recognized in the cost certification review.

B. The Application for Insurance of Advance of Mortgage Proceeds (HUD-92403) is initiated by the Borrower. The initial and final advances are submitted by the Lender to HUD for review and approval. Interim advances are approved by the Lender (including those advances requesting a Partial Release of Retainage), based upon the HUD Contract Inspectors' approval of the construction amount using the Contractor's Requisition – Project Mortgages (HUD-92448). (Mortgagee signs the Application for Insurance of Advance of Mortgage Proceeds, and Contractor's Requisition – Project Mortgages as described in C. below.)

C. For the initial and final advances, the ORCF Closer and ORCF Workload Manager (WLM) sign the Application for Insurance of Advance of Mortgage Proceeds, and Contractor's Requisition – Project Mortgages, in the following spaces:

1. CC signs in Mortgage Credit Examiner box, and WLM signs as Authorized HUD Official, for the Application for Insurance of Advance of Mortgage Proceeds, and

2. CC signs as Chief Mortgage Credit, and WLM signs under Director, Housing Development, for the Contractor's Requisition – Project Mortgages.

3. Supporting materials to the Application for Insurance of Advance of Mortgage Proceeds include supporting bills/receipts and the Contractor's Requisition – Project Mortgages, if requesting construction funds.

D. The Lender's role in processing the Application for Insurance of Advance of Mortgage Proceeds is as follows.

1. Completes application indicating:
    a. Amount requested by Borrower;
    b. Approximate disbursement date;
    c. Amount to be advanced from mortgage proceeds;
    d. Amount disbursed from Borrower's front money escrow, if any; and
    e. Total loan proceeds disbursed including current request.

2. Submits initial and final application to ORCF Closer for review and approval.

3. Processes and approves interim advances.

4. Ensures clear title before advancing the approved disbursement.

5. Notifies HUD in writing if clear title does not exist.

E. 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 Closing of the credit instrument. The initial advance will be reviewed by the ORCF Closer, and executed by the ORCF Closer and ORCF WLM. The Lender shall submit the Application for Insurance of Advance of Mortgage Proceeds, Application for Insurance of Advance of Mortgage Proceeds, with supporting documentation for HUD approval.

2. Interim advances. Interim advances are subsequent applications up to completion of the project. Interim advances will be processed and approved by the Lender.

3. Next to Final Advance. When HUD has consent from the Borrower, and surety, if any, all but 2 ½% of the construction retainage may be released.
   Note: This only applies to non-identity of interest General Contractors or where the General Contractor's identity of interest is a project ownership of less than 5 percent.

4. Final Advance. It is any remaining balance of mortgage proceeds at Final Closing. 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, using the Application for Insurance of Advance of Mortgage Proceeds, is to be processed by HUD.

F. Instructions for Approval of Initial/Interim Advances. These instructions can be found in Appendix 10.2.

G. General Contractor's Monthly Requisition and Related Matters. See Appendix 10.3 for instructions on completing the Contractor's Requisition – Project Mortgages, and related matters.

H. Next to Final Advance. The final advance is requested when construction is acceptably complete, even though there may be items of delayed completion.

   1. It may provide for the release of the General Contractor's retainage provided the conditions in Section 10.15.D have been met.

   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.

I. Final Advance. The Application for Insurance of the Final Advance requests any remaining balance of mortgage proceeds. It ensures that:

1. The Borrower's cost certification has been approved and the Maximum Insurable Mortgage Letter has been issued approving the final maximum mortgage amount. See Production, Chapter 11.

2. The Application for Insurance of Advance of Mortgage Proceeds is accompanied by a completed Contractor's Requisition – Project Mortgages, with required Contractor's Prevailing Wage Certificate, if the General Contractor's retainage has not been previously disbursed. Refer to Section 10.15.D for instructions on releasing the General Contractor's retainage.

3. The sum to be approved for advance is the balance of the mortgage proceeds, based on the final approved Mortgagor's Certificate of Actual Cost (HUD-92330).

4. Establishment of the escrow under the provisions of the Escrow Agreement for Incomplete Construction (HUD-92456-ORCF).

5. Request for Final Endorsement of Credit Instrument (HUD-92023-ORCF), or Commitment to Insure Upon Completion (HUD-92453-NH), have been submitted and reviewed.

J. For instructions on establishing the escrow for the Borrower's unpaid construction costs under the provisions of the Escrow Agreement for Non-Critical Deferred Repairs (HUD-92476-ORCF), see Production, Chapter 9.

K. Keeping the mortgage in balance.
Soft cost overruns such as interest, taxes, MIP, and insurance resulting from construction delays at the fault of the General Contractor (i.e., poor performance) are funded from the liquidated/actual damages clause in the construction contract. This clause is not a penalty. It instead provides a source of funds to cover the increased soft costs. When the interest allocation is near exhaustion, HUD should be notified immediately. The Lender should follow the following procedure:

1. When the interest allocation is near exhaustion, ask the Architect and the HUD Contract 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 the Financial Record of Mortgage Loan Transaction (HUD-92451).
    d. Allocate full amount to interest, initially.
    e. Funds may be used for MIP, taxes, or insurance payments, if requested, after the funds for these line items and non-profit 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 Borrower, General 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 Contractor's Requisition – Project Mortgages' 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 the Contractor's Requisition – Project Mortgages, before releasing the General Contractor's retainage, make adjustment for the lesser of actual or liquidated damages determined in the cost certification review.

7. This procedure should be invoked only if, after consulting with ORCF Management, it can be confirmed that the problems causing the delay will be remedied within a reasonable time.

10.9 Construction Change Orders – General

A. General Instructions. Construction contract changes (change orders) must be requested by the Borrower through the Lender. Request for Construction Changes on Project Mortgages (HUD-92437) is used for on-site changes during construction in all projects involving Insurance of Advances of Mortgage Proceeds, and Insurance Upon Completion, when the change involves a change in the scope of work, or a change in construction time. Multiple construction changes may be placed on a single form. However, both a construction change(s) and a time extension change may not be listed on the same form. Forms must be signed by the Borrower's Architect, the Borrower, the General Contractor, and the Lender (including the Lender's Architectural Reviewer, Cost Analyst, Appraiser, and Mortgage Credit Specialist, as necessary). The Contract Inspector shall review the change order for technical acceptability and for duplication within the drawings and approve or disallow prior to submission to the Lender for approval. Final change order approval is made by the ORCF CM.

1. The General Contractor shall maintain a Change Order Log, showing the status of potential Change Orders. An updated copy must be kept on site, in the construction office, and a copy provided to the HUD Contract Inspector whenever changes are made to the Log.
2. The project Architect shall draft and assemble attachments for each Change Order clearly describing each change, and the reason for the change. Required attachments for physical changes include:
    a. Appropriate modifications to the contract drawings and specifications**,**
    b. An Architect's narrative confirming that the change(s):
        i. Conforms to the original intent of the contract drawings and specifications; or
        ii. is necessary to overcome an impediment to construction; or is a betterment, an equivalent, or an addition desired by the Borrower,
        iii. is permissible under the applicable zoning, building, housing, and other codes, ordinances and/or regulations, as modified by any and all waivers obtained from appropriate officials,
        iv. incorporates foundation designs that reflect site soils limitations and design recommendations included in the foundation soils report and any other geotechnical reports (if applicable),
        v. complies with the HUD Minimum Property Standards; all applicable accessibility laws for persons with disabilities, including the Fair Housing Accessibility Guidelines, and the Uniform Federal Accessibility Standards (Direct link: http://portal.hud.gov/hudportal/documents/huddoc?id=AccessMatrixSec232.docx); as well as any state or local law that requires higher accessibility requirements; and all other applicable HUD Standards, guidelines and criteria,
        vi. complies with the applicable State Energy Efficiency Design Code,
        vii. for Substantial Rehabilitation, structures in seismic zones 3 and 4 meet three fourths (3/4) of the seismic force level resistance contained in ASCE 31-02: Seismic Evaluation of Existing Buildings, American Society of Civil Engineers, as determined by a registered engineer familiar with lateral force design (if applicable), and
        viii. incorporates noise attenuation measures which are sufficient to mitigate interior noise levels to an "Acceptable" level and complies with the recommendations of the Noise Engineer (if applicable).
    c. Backup documentation for amount(s) requested consisting of itemized quantities and costs (including itemized Builder's Fees).

3. After the General Contractor or Supervisory Architect has drafted the Change Order, and included all necessary attachments, the Contract Inspector will review the change order in the field for technical acceptability and for duplication within the drawings. If necessary, the Lender's Architectural Reviewer and Cost Analyst (per the instructions below), and Lender's Appraiser and Mortgage Credit Specialist (as required by the instructions below), will then review and process the Change Order. The Change Order is then reviewed and signed by the Lender, who then sends the

complete Change Order package to the ORCF CM for final review and approval. Copies of the fully executed Change Order will then be distributed as listed below.

4. Approve change orders only when they are necessary, a betterment, or an equivalent. The following information shall appear in the Change Order submission:
    a. Classification (necessity, betterment, etc.);
    b. Qualification for payment from the contingency reserve, or Borrower cash escrow;
    c. Whether change order results from error, omission, or negligence on the part of the Architect, General Contractor, or Borrower.

5. Do not approve any change orders submitted after the final HUD Contract Inspector's Trip Report, except where:
    a. The change order pertains to "Items of Delayed Completion," or
    b. Prior written approval is given by the ORCF CM.

6. 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.

7. Change Orders must be submitted in a timely manner. HUD regulations prohibit processing of change orders after the Final Trip Report.

8. The form selected must be signed by:
    a. Borrower,
    b. General Contractor,
    c. Architect, and
    d. Lender

9. All offsite changes must be:
    a. Requested in a letter or other format acceptable to ORCF. The Request for Construction Changes on Project Mortgages shall not be utilized for this purpose.
    b. The request will be otherwise documented and processed in the same manner as on-site changes.

10. HUD will endeavor to promptly review all requests submitted. All construction change requests must be reviewed, signed, and dated by the ORCF CM.

11. Voiding Changes. If an approved change is not made, it must be nullified by a Request for Construction Changes on Project Mortgages restoring the drawings and specifications to the status prior to the change request or to a status acceptable to HUD.

12. Unapproved Changes. When there are unapproved changes in construction, the HUD Contract Inspector is required to modify the amount of the General Contractor's requisition to cover any additional costs related to the unapproved construction including, without limitation, those required to remove work that does not conform to the plans and specifications as approved by HUD originally or in accordance with approved Change Orders.

B. General Change Order Policies.

1. Changes must be accurately reported and accounted for pursuant to U.S. Criminal Code, Section 1010, Title 18, U.S.C.

2. The Change Order process is not to be implemented as a means for making fundamental alterations to a project as approved and underwritten, particularly with respect to retaining its full operational functions, amenities, and value.

3. HUD does not initiate any changes but may require them as a condition of approval in connection with a change proposed by the Architect, Borrower, or General Contractor.

4. All changes must be approved in writing by the Lender and HUD before related work begins.

5. Any change that is made without formal approval, even though tentatively agreed to as technically acceptable, must be recorded by the Contract Inspector as a noncompliance. This stands until, and unless, the Request for Construction Changes on Project Mortgages, is approved, and also affects payment of advances.

C. Change Order Classification.

1. Necessary changes are those that arise from:
    a. Latent conditions that differ from conditions contemplated by the construction documents;
    b. Changes in the applicable codes, ordinances, etc. after:
        i. Initial closing for insured advances;
        ii. Firm Commitment for insurance upon completion;
    c. Errors or omissions by the Architect;
    d. Physical damages 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;
    c. Otherwise enhance the value of the mortgaged property.

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. An Additive Change Order does not give any explicit or implied assurance that an increase in the insured mortgage amount will be granted.

1. Require the Borrower, 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.
    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 General Contractor estimated costs in excess of HUD estimated costs, or HUD estimated costs in excess of General 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 General Contractor's cost estimate exceeds the HUD estimate.
    b. Authorize use of excess mortgage proceeds, if available, to satisfy the escrow requirement 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 General Contractor estimated costs in excess of HUD estimated costs, or HUD estimated costs in excess of General Contractor estimated costs, may not be disbursed until final closing.

3. Approve the following forms for Borrower's application of funds for completed additive change orders:
    a. Request for Approval of Advance of Escrow Funds (HUD-92464), where an escrow is used. Note: This form must be submitted to HUD for approval.
    b. The Application for Insurance of Advance of Mortgage Proceeds, where a rehabilitation project's contingency funds or non-profit'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 "final" Contractor's Requisition – Project Mortgages, 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 – Project Mortgages, 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 General 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 General 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 General Contractor's general requirements by use of a cash escrow, or excess mortgage proceeds, or non-profit'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 General 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.

H. Changes to Items of Delayed Completion. These are the only construction contract changes that ORCF can approve after project completion. All others require ORCF consent.

I. Emergency changes.

1. The only time a change can be made without prior written approval of the Lender and HUD is in emergencies that:
    a. Endanger life or property; or
    b. Halt construction.

2. In these instances, the Architect must notify the Lender and HUD and, as soon as possible, submit a Request for Construction Changes on Project Mortgages.

J. Insurance Upon Completion. The Request for Construction Changes on Project Mortgages, are processed in the same way as Insurance of Advance cases, except as modified:

1. An escrow is not required for additive change orders. The Borrower:
    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. The Request for Construction Changes on Project Mortgages may be used as a general guide, but the form itself may not be utilized for this purpose.

L. Other Changes. These changes necessitated by error, omission, or negligence of Architect, Borrower, or General Contractor must be so recorded by HUD architectural staff or Contract inspector, the Request for Construction Changes on Project Mortgages.
    1. Record the reason for the determination.
    2. Indicate that the cost effect must not be included in the mortgage amount.

M. Distribution of fully executed Change Orders: Lender, Borrower, Supervisory Architect, General Contractor, and HUD Contract Inspector.

10.10 Change Orders – HUD Contract Inspector Instructions

A. 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.

B. Contemplated changes are first discussed among the Architect, General Contractor, Borrower, and HUD Contract Inspector.

C. The HUD Contract Inspector will make a preliminary determination of technical acceptability before a change order is submitted for approval of the Lender and the HUD Office. (This preliminary determination neither commits HUD to the change, nor relieves the Architect or the General Contractor from completing the process described below.)

10.11 Change Orders – Lender's Architectural Reviewer and Cost Analyst's Instructions

A. Architectural Reviewer. Review all requested changes for technical acceptability.

B. Cost Analyst.

1. Construction changes:
    a. The Lender's Cost Analyst will produce a cost estimate for each construction change request submitted by the Borrower. 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 the "Replacement Cost" tab of the Maximum Insurable Loan Calculation (HUD-92264A-ORCF) at Firm commitment.
    b. Compare estimate with Borrower's estimate. If reasonable, use Borrower's figure, otherwise use HUD estimate.
    c. Complete cost entries on the Request for Construction Changes on Project Mortgages and forward completed form to the Lender's Appraiser and Mortgage Credit Specialist, if applicable (see "Lender's Appraisal and Mortgage Credit Instructions," below)

2. Approved time extensions:
    a. Calculate additional general requirements cost due to extension of time.
        i. Divide cost of general requirements from the approved Contractor's and/or Mortgagor's Cost Breakdown (HUD-2328) by the number of months estimated for construction from the "Replacement Cost" tab of the Maximum Insurable Loan Calculation at Firm commitment. Sixty-five percent of this amount is the estimate per month of additional general requirements.
        ii. Use one quarter of the monthly estimate per week.
        iii. There is no cost effect for extensions of time for less than one week (seven calendar days).
    b. Complete cost entries on the Request for Construction Changes on Project Mortgages and forward completed form to the Lender's Mortgage Credit Specialist (see "Lender's Appraisal and Mortgage Credit Instructions," below)

10.12 Change Orders – Lender's Appraisal and Mortgage Credit Instructions

A. Appraisal.

1. The Lender's Appraiser must review all requested changes that may affect marketability, value, income, or maintenance or operating cost. The Lender's Appraiser must identify and explain any estimated increase or decrease in net project income on the reverse of the Request for Construction Changes on Project Mortgages.

2. If applicable, per A.1 above, the Lender's Appraiser must forward a Maximum Insurable Loan Calculation reflecting the new data for the Lender's Mortgage Credit Specialist's re-determination of the maximum insurable mortgage.

B. Mortgage Credit.

1. Processing.
    a. If the Borrower's or General 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 Borrower's or General Contractor's estimate must be restricted and held until Final Closing 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. 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.
        i. Require the Borrower, 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.
            1. 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 General Contractor estimated costs in excess of HUD estimated costs, or HUD estimated costs in excess of General Contractor estimated costs, may not be disbursed until final closing.
            2. 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.

3. Recognize the cost of third party paid change orders at cost certification, where there are available mortgage savings.

ii. 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.
    1. Require an escrow for any amount that the General Contractor's cost estimate exceeds the HUD estimate.
    2. Authorize use of excess mortgage proceeds, if available, to satisfy the escrow requirement, subject to the disbursement limitations in 1 a. above.

iii. Approve the following forms for Borrower's application of funds for completed additive change orders:
    1. Request for Approval of Advance of Escrow Funds, where an escrow is used. Note: This form must be submitted for approval.
    2. The Application for Insurance of Advance of Mortgage Proceeds, where a rehabilitation project's contingency funds excess mortgage proceeds are used.

d. Deductive Change Orders. Where HUD estimated decrease in contract price for any aggregation of change orders:
    i. Remains less than 2 ½ percent of the contract price, reduce the "final" Contractor's Requisition – Project Mortgages, by the appropriate amount.
    ii. Equals or exceeds 2 ½ percent of the contract price and for all subsequent deductive change orders regardless of the amount:
        1. Reflect the decrease in the Contractor's Requisition – Project Mortgages, Item (8)
        2. Reduce the original mortgage amount at cost certification, where required.

e. 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.
    i. Lender's Appraiser completes a Maximum Insurable Loan Calculation with an updated income and expense analysis.
    ii. Re-determine the maximum insurable mortgage.
    iii. 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 the Request for Construction Changes on Project Mortgages that subsequent Contractor's Requisition – Project Mortgages, must be reduced by the greater of:
        1. The difference in mortgage amounts;
        2. The net increase in costs resulting from acceptable construction changes.

f. Extensions of time.
    i. Lender's Architectural Reviewer, and Cost Analyst are responsible for determining whether the delay was beyond the General Contractor's control and, if so, the length of the approved time extension.
    ii. Calculate the cost increase due to the extension:
        1. Compute daily rate for interest, taxes and insurance by using estimates in the "Replacement Cost" tab of the Maximum Insurable Loan Calculation and multiply these rates by the approved time extension.
        2. An additional year of MIP will be required if the approved time extension, when added to the estimated construction term plus the 2 months included in the "Replacement Cost" tab of the Maximum Insurable Loan Calculation plus previously approved time extensions, will require an additional MIP payment during the construction period.
        3. Add the additional general requirements, if any, noted by the Lender's Cost Analyst on the change order request.

NOTE: Only Item 3 above amends the construction contract price on the Request for Construction Changes on Project Mortgages.

    iii. Determine the source of funds for any increase due to the extension, i.e., cash, excess mortgage proceeds or non-profit's Developer's fee, or contingency reserve funds.
    iv. Requests for release of excess mortgage proceeds or contingency reserve funds set aside to fund time extensions are submitted on the Application for Insurance of Advance of Mortgage Proceeds.
    v. Releases from a cash deposit are made using the Request for Approval of Advance of Escrow Funds.
    vi. These funds may be released only after the account for the soft cost item(s) being requested has been exhausted on the Financial Record of Mortgage Loan Transaction.

2. Requests for disbursement of contingency reserve funds and non-profit's Developer's fee for completed change order items are made on the Application for Insurance of Advance of Mortgage Proceeds. All requests:
    a. Must be accompanied by a certification by the Borrower's supervisory Architect and the Contract Inspector that all the work covered by the change order has been acceptably completed in accordance with contract documents;
    b. Must include the Borrower's certification relative to payment to the General Contractor contained on the Request for Approval of Advance of Escrow Funds;
    c. Must include the criminal certification contained on the Request for Approval of Advance of Escrow Funds for certifications made in paragraphs a and b above;
    d. Are subject to a 10 percent retainage.

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 General Contractor's estimate which exceeds the HUD estimate. The portion which exceeds HUD's estimate must be restricted until Final Closing.
    b. Funds are released in the same manner as contingency reserve funds.

4. Releasing Cash Deposit. The Borrower submits through the Lender the Request for Approval of Advance of Escrow Funds when construction covered by a cash deposit is complete and acceptable to HUD.
    a. The Borrower's supervisory Architect and the HUD Contract Inspector must certify on the Request for Approval of Advance of Escrow Funds 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 Borrower 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 Application for Insurance of Advance of Mortgage Proceeds is submitted, the Borrower 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 Borrower;
    b. The date HUD received the change order;
    c. The date the Lender's Mortgage Credit Specialist processed the change order;
    d. The Borrower's or General 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, non-profit'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.

10.13 Labor and Fair Housing and Equal Opportunity (FHEO)

A. Wages

1. Payrolls. General Contractor payrolls are submitted directly to the designated HUD Labor Relations Specialist weekly for each week in which contract work is performed.

2. On-site interviews. The ORCF CM forwards PDF copies of the Record of Employee Interview (HUD-11), which are submitted by the HUD Contract Inspector, to the HUD Labor Relations Staff.

B. Labor violations. The CM shall advise the Labor Relations Staff of continuing minor infractions that cannot be resolved or of any identified or suspected major violations.

C. FHEO violations. The CM shall advise the applicable HUD Director of FHEO of continuing minor violations that cannot be resolved or of any identified or suspected major violations.

10.14 Surveys

Surveys must be performed by a licensed surveyor and show the exact location of on-site improvements, including utility lines and easements, as described in the Survey Instructions and Borrower's Certification, and as outlined below:

A. The General Contractor must give the Borrower and HUD surveys:

1. At any time the Borrower or HUD requires, and

2. When construction is complete ("as-built" survey).

B. The HUD Contract 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 General Contractor's requisition.

C. If encroachments are found, the HUD Contract Inspector must notify the ORCF CM by memorandum explaining the conditions. (Encroachments may jeopardize the entire property as security for an insured mortgage.)

10.15 Escrowed Funds, Letters of Credit, Deposits, Retainage and Related Matters

A. Borrower's Application for Escrowed Funds.

1. Request for Approval of Advance of Escrow Funds, must be used where the escrow is to ensure completion of offsite improvements, demolition, additive change orders, minor movable equipment, non-critical repairs (under the Section 223(f) program), or Borrower's unpaid construction items at Final Closing.

2. The Borrower initiates and forwards the Request for Approval of Advance of Escrow Funds to the Lender for its review before submitting the disbursement request to HUD for approval.

3. Require the HUD inspector to reflect the percentage of acceptably completed escrow work on the HUD Representative's Trip Report, and forward a copy after review to the Lender for use in reviewing the Request for Approval of Advance of Escrow Funds.

4. Do not authorize advances in excess of the documented percentage completed, less previous payments and a 10 percent retainage.

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 pre-operations marketing and initial rent-up. This includes: sales and advertising, model furnishing, and equipment and supplies essential to initial rent-up, etc.;
    b. Escrow funds for items due during the first operating year that project income is not expected to cover, including real estate taxes, permanent property insurance premiums, ground rents and assessments;
    c. Cover shortfalls in interest, taxes, property insurance premiums, ground rents and assessments during construction after funds available under the Building Loan Agreement are exhausted;
    d. Potentially allocate funds to the Reserve for Replacement (R4R) account for a project with low income housing tax credits, where acceptable to the Borrower and HUD;
    e. The new construction contingency portion of the escrow will be used for change orders and cost overruns.

2. Control and Release of Escrow. The Lender controls disbursements from the escrow, subject to HUD approval where appropriate (where required by escrow agreement), except where the Borrower certifies at firm commitment that any balance of the escrow will be applied to the reserve for replacements or additional betterments on a

LIHTC, Historic Tax Credit, or New Markets Tax Credit project. In reviewing a Borrower's request for release of part of the escrow, consider the following:

a. Borrower's request for the release of such escrow funds must be by letter to the Lender, rather than on the Application for Insurance of Advance of Mortgage Proceeds;
b. None of the escrow can be used to defray any of the hard costs of construction applicable to the "Total for All Improvements." in the "Replacement Cost" tab of the Maximum Insurable Loan Calculation;
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. ORCF may require that the deposit be used to cover any shortfall in interest, taxes, property insurance, ground rent and assessments;
f. Fully document all expenditures from the escrow.

3. Final Release of Escrow.
    a. The Lender may release any balance in the working capital escrow to the Borrower 12 months after Final Closing where the project is not in default and when the project has demonstrated to ORCF's satisfaction that the project has achieved break-even occupancy for each of six consecutive months. Break-even occupancy is defined as 1.0 debt service coverage, based on all sources of Project income including ancillary income.
    b. The Lender must hold this escrow until any project 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 the Escrow's release.
    d. The working capital new construction contingency will be refunded to the Borrower at Final Closing, if not used.

D. Amount of General Contractor's 10 percent retainage and release. The retainage provides an incentive for the General Contractor and Borrower to: promptly complete the project, submit cost certification and reach final closing.

1. Amount of retainage. 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 retainage from the General Contractor's monthly payments for acceptably completed work, acceptably stored materials, and where applicable, components acceptably stored offsite. The requirement for contingency release is as follows:
    a. The General Contractor has no identity-of-interest with the Borrower 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 General Contractor's performance concerning the quality of work, compliance with the contract and any change orders or work in progress;
d. Assuming these conditions are met, the existing standard of 10% retainage will be required only until 90% completion. After 90% completion, the requirement will be 5% retainage until 100% completion and 2.5% retainage until the loan reaches Final Closing.

2. Release of retainage for identity of interest General Contractor. Except as provided in paragraphs 4 and 5 below, do not release any part of the retainage until final closing for a General Contractor with an identity of interest.

3. Release of retainage for non-identity of interest General Contractor. Release the General Contractor's retainage or remaining balance at the next to last advance, where requisitioned on the Application for Insurance of Advance of Mortgage Proceeds, and subject to compliance with the following:
    a. General Contractor's cost certification, where required, has been reviewed and approved;
    b. General Contractor has disclosed its final obligations on the 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 – Project Mortgages has been issued by HUD for all units;
    f. All Davis Bacon payroll requirements have been satisfied;
    g. As-Built Survey, has been submitted to HUD, per the Survey Instructions and Borrower's Certification (HUD-91111-ORCF), and
    h. Retain, where applicable, an adequate amount for the following:
        i. Items of delayed completion in an amount equal to 150 percent of the HUD Inspector's cost estimate for completion,
        ii. Any owed or contested amounts indicated by mechanics, subcontractor, supplier, or equipment lessor liens, etc.
        iii. Lessor of the liquidated damages or actual damages computed at cost certification, and
        iv. Net effect of negative change orders.

4. Early partial release of retainage.
After 90 percent construction completion, the ORCF CM may approve the partial release of the General Contractor's retainage, and suspend further withholding of retainage from payments due, where:

a. The General Contractor has no identity of interest or the General Contractor's only identity of interest is a project ownership of less than 5 percent;
b. The General Contractor, Borrower and mortgagee request the early release of the retainage in accordance with Appendix 10.4, and attach the request to the Application for Insurance of Advance of Mortgage Proceeds; and
c. The surety, if any, has provided written consent to the release

d. The ORCF CM determines that:
    i. The General Contractor's general performance warrants partial release of the retainage without conditions, and
    ii. There are no significant outstanding Labor Standards / Davis-Bacon issues (if applicable), or
    iii. Partial release of the retainage with conditions, e.g., measures to assure immediate distributions to subcontractors or others would be in the mutual interest of all participants.
e. The un-disbursed retainage must equal or exceed 5 percent of the contract amount.

5. Projects in difficulty. Release of part of the General Contractor's retainage 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. Review the General Contractor's performance including:
        i. The completed work must be satisfactory;
        ii. The percentage of completed contract work must be sufficient to ensure project completion within the specified contract time; and
        iii. Do not release any retainage if there are serious, unresolved questions concerning:
            1. Quality of work,
            2. Compliance with the contract, including outstanding change orders, or
            3. Work is progressing behind the General Contractor's construction schedule, as amended by approved change orders.
    b. Require a written consent for the early release of retainage from the surety, if any, the Borrower and mortgagee.

E. Release of the Initial Operating Deficit. ORCF's AE will consider Lender requests for initial operating deficit draws during lease-up. The Lender's request must be accompanied by:

1. 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

2. 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.

3. Unused portions will be returned to the Borrower twelve months after final closing and when the project has demonstrated to ORCF's satisfaction that the Project has achieved a debt service coverage ratio (including the Mortgage Insurance Premium) of at least 1.45 for each month of three consecutive months. The Lender is responsible for insuring that escrow funds are released solely for project operating needs.

10.16 Completion of Repairs Pursuant to Section 223(f) and 223(a)(7)

A. Required Repairs are documented by the Lender's Needs Assessor. 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;
    e. Require correction of accessibility deficiencies (See Accessibility Matrix available on the Section 232 Program website. Direct link: http://portal.hud.gov/hudportal/documents/huddoc?id=AccessMatrixSec232.docx).

2. Non-critical Repairs consist of all repairs other than Critical Repairs. Non-critical Repairs may, at the request of the Borrower, be completed after closing.

3. Completion of repairs.
    a. Completion of repairs before closing. Lender shall submit a completed Owner's Certification - Completion of Critical Repairs (HUD-91118), to HUD for review and approval.
    b. Completion of repairs after closing. See Asset Management, Chapter 3.2.4 for details regarding Non-Critical Repair Escrows.

4. Payment for Repairs.
    a. Repairs completed before closing: No mortgage proceeds may be advanced.
    b. Repairs completed after closing: Shall be funded from the Non-Critical Repair Escrow established at Initial Closing.

B. Repair completion. All work must be acceptably completed before the loan closing, except for the following:
    1. Exterior Repairs, that cannot be completed because of weather conditions, may be completed after closing, with prior ORCF approval. 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 delayed repairs which will delay or interrupt occupancy or income for any period.

10.17 Major Movable Equipment – Requisitions, Inspections, and Changes to Equipment Schedule During Construction

A. Requisitions.

1. The Borrower prepares the Application for Insurance of Advance of Mortgage Proceeds, indicating the total amount of Major Movable Equipment delivered to the site and installed or stored onsite.

2. Related attachments will include:
    a. A summary sheet, and detailed lists all Major Movable Equipment purchased and installed/stored on site within the past month;
    b. All invoices for equipment purchased.

NOTE: *Deposits* for Major Movable Equipment are not eligible for funding from mortgage proceeds.

B. Inspection of Major Movable Equipment.

The HUD Contract Inspector:

1. Confirms delivery and installation (or acceptably stored on site) of Major Movable Equipment and the invoice amounts;

2. Will only approve payment for equipment actually delivered and installed/stored on site, and may change the listed equipment and requested amount on the Application for Insurance of Advance of Mortgage Proceeds accordingly, to agree with actual delivery and installation / storing;

3. Initials the summary sheet, and documents their observations and conclusions in the HUD Representative's Trip Report.

C. Changes to the Major Movable Equipment (MME) Schedule during construction.

1. Lender requires the Borrower to submit a revision of the itemized MME list. The revised MME list should itemize which specific MME items are being replaced, and

contain a complete description and cost of the MME items that have been chosen as replacements.

2. The Borrower presents the revised MME list to the Lender for review. The Lender reviews the revised MME list and certifies that the replacement MME items are of equal quality and will perform the intended function of the MME items being replaced. Lender forwards a copy of the revised MME list and certification to the ORCF CM.

3. The ORCF CM forwards a copy of the revise MME List to the HUD Contract Inspector.

Note: If a revised MME item costs more than the item being replaced, the price differential *may* be paid from the Working Capital Escrow.