

CHAPTER 5. COST CERTIFICATION

5-1. GENERAL. Cost certification is required by Section 227 of the National Housing Act and HUD Regulations in all multifamily projects, except those insured under Section 810(g) of the Act, Rehabilitation Sales type projects under Sections 221(h) and 235(j) and sales type projects under Section 213.

- \* a. Joint Pre-Cost Certification Conference. The cost and Mortgage Credit staffs shall hold a joint pre-cost certification conference with the mortgagor, mortgagee, general contractor, and accountant when the project has attained a construction completion percentage of no more than 90 percent. At this conference, provisions of Reference (5) of the Foreword shall be explained and the mortgagor and contractor shall be asked to submit the required statements and certifications. The importance of a careful review by all parties, including the mortgagee, mortgagor and accountant, prior to submitting the cost certification documents to HUD shall be stressed. Particular emphasis shall be placed on the necessity for completeness with respect to required documentation, dates and signatures and upon the timeliness of the submission.
- b. As a general rule, only costs which have been paid in cash or will be paid in cash upon release of the balance of mortgage proceeds are eligible for inclusion as certified cost.
- c. Excepted are, amounts allowable for land, for general overhead, and for builder's fee where there is an identity of interest between the builder and mortgagor.
  - (1) The exception as to builder's fee does not apply when there is an arm's length relationship between mortgagor and builder.
  - (2) The builder's fee loses its identity as such, and only that portion of the (arm's length) contract price (inclusive of the fee) paid in cash or to be so paid at final closing, is includable.

5-2. REQUIRED STATEMENTS.

- a. Form FHA-2330, Mortgagor's Certificate of Actual Cost, is required in all cases, unless the simplified cost certification, Form FHA-2200, Borrower's Certificate of Actual Cost,

- \*(5-2) is required in all projects where there is an identity of mortgagor and general contractor as well as the identity of interest situations stated in 5-2 b below.
  - (1) Forms FHA-2330 and FHA-2330A have declarations as to any identity of interest or the absence thereof, printed on the

forms. The use of these forms is mandatory, and all questions as to identity of interest must be answered. It should be noted that the back of Form FHA-2330 requires the mortgagor's signature and also requires that either (a) a description of identities be given or (b) the word "none" be inserted.

- (2) If there is an identity of interest between mortgagor and general contractor; any subcontractor, supplier or lessor having identity of interest with general contractor will be treated as having an identity with the mortgagor. A separate form, executed in triplicate, is required for each subcontractor, supplier, or lessor.
- b. Form FHA-2330-A, Contractor's Certificate of Actual Cost must be completed and submitted by the following:
- (1) General contractors when there is an identity of interest between the general contractor and the mortgagor.
  - (2) General contractors for a non-profit project, when a cost plus contract is executed.
  - (3) Any subcontractor, material supplier or lessor of equipment having an identity of interest with the mortgagor regardless of the type of contract.
  - (4) Any subcontractor, material supplier or lessor of equipment having an identity of interest with the general contractor who has an identity of interest with the mortgagor or is the general contractor for a non-profit mortgagor.

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- \*(5-2) c. Submissions Required with Form FHA-2330-A by Subcontractors and Equipment Lessors. Each such subcontractor, supplier, or lessor will be required to submit a certification of actual costs.
- (1) For subcontractors, Form FHA-2330-A will be used. Suppliers will generally be required to submit a listing of quantities furnished, sources from which suppliers obtained materials, and unit prices charged, together with brand names, model number, lumber grades, etc., as applicable. However, the Field Office Director, may accept, in lieu of the supplier's costs, a breakdown of quantities, item descriptions, and unit prices charged if the supplier has been established in the community as a supplier of the type of materials involved.
    - (a) If the prices are at or below the best obtainable at the time of purchase, no reduction in certified cost is needed.
    - (b) It should be noted, however, that this prerogative applies to materials and supplies which are of a type normally offered to general contractors and the public

by the supplier and would not include equipment such as refrigerators and ranges which general contractors normally purchase from manufacturers at wholesale prices.

(2) For construction equipment lessors, the date equipment was acquired, the age of equipment at acquisition date, model numbers, etc., rates charged, and time used will be required together with a certification that:

- (a) Rates charged were not more than the lowest rate obtainable in the area;
- (b) Time charged was not more than was absolutely essential for the job;

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- (5-2) (c) The charge for each piece did not in any case exceed the difference between the fair market value of the piece at the time it was brought on the job and its fair market value at the conclusion of its use on the job.
- (3) In lieu of furnishing a certification as to the date equipment was acquired, age of equipment at acquisition date and model numbers, etc., plus the certification required under Paragraph 5-2c above, the lessor may elect to certify charges for self-owned equipment at 85% of the going rates for equipment of like capacity and conditions as established by the Associated Equipment Distribution rental rate guide or a comparable acceptable publication. In this type of arrangement, the equipment owner must agree:
- (a) That HUD-FHA will be the sole judge of the reasonableness of time charged for; and
  - (b) That equipment maintenance and repair costs will be the responsibility of the lessor and will not be included as additional cost.
- (4) If the total of all identity of interest subcontracts, purchases, and leases for a project is less than the greater of \$10,000 or 1/2 of 1% of the mortgage amount, the Field Office Director may in his discretion waive the requirement of this subparagraph c.
- (5) Even if the total involved is greater than either of the limits set in the paragraph above, the Field Office Director may agree in writing in advance to waive certification by a subcontractor, provided all of the following conditions are met:
- (a) A disclosure of the identity of interest must be made to the Field Office Director, and a copy of the subcontract furnished to him before the subcontractor

starts to work;

- (b) The Field Office Director must be satisfied that the subcontractor is competent and experienced in the field covered by the subcontractors:

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- (c) The Field Office Director must be satisfied that the subcontract price is no greater than the most favorable price that could have been obtained from an "arms length" subcontractor.

- (6) A comparable waiver, under the same conditions, may be granted to equipment leasing corporations having an identity of interest.

- d. Balance sheet. A signed balance sheet of the mortgagor entity, as of the cut-off date of Form FHA-2330, Mortgagor's Certification of Actual Cost, is required in all cases, except presold Management Type Cooperatives involving more than one section Short term liabilities shown on the balance sheet must be in agreement with Column B of Form FHA-2330, or reconciling information must be furnished. The mortgage payable must agree with HUD records as to both disbursed and undisbursed portions, and all other liabilities must be in the form of HUD approved notes.

- (1) If the undisbursed portion of mortgage proceeds is not sufficient in amount to pay all items listed under Column B of Form FHA-2330, the mortgagor shall be required to deposit with the mortgagee (or an escrow agent) cash sufficient to meet the deficiency.

- (2) In cases where such cash deposit is required, the mortgagee (and/or escrow agent) shall be required to supervise the distribution of funds to creditors.

- (3) Where there is an identity of interest between mortgagor and contractor, supervision over the distribution will, of course, extend to payment of trade creditors of the general contractor.

- \*5-3. ACCOUNTANT'S CERTIFICATION REQUIRED. Each Form FHA-2330 and FHA-2330A must be accompanied by the certificate of an independent Certified Public Accountant or an independent Public Accountant containing, as a minimum, the representations in the format shown in Appendix 1 of Reference (5) of the Foreword.

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- \*5-4. SUFFICIENCY OF CERTIFICATION. The Assistant Secretary-Commissioner reserves the right to determine whether or not the certified statement of cost is satisfactory to HUD. To be acceptable, an accountant must be a certified public accountant or a public accountant licensed by a

regulatory authority of a State or other political subdivision of the United States on or prior to December 31, 1970. As required by the American Institute of Certified Public Accountants (AICPA) standards, the accountant must be independent within the meaning of the code of professional ethics of AICPA.

- 5-5. UNACCEPTABLE CERTIFICATION. Certifications which do not contain the required mind representations or are inconsistent with the format set forth in Appendix 1 of Reference (5) of the foreword shall be considered unacceptable.

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- 5-6. EVALUATION OF COST SUBMISSION. Neither the signature of the mortgagor/contractor, nor the accountant's certification nor the requirement for the Field Office Director's review, operates to relieve the Field Office Director from his primary responsibility to pass on the mathematical accuracy and the compliance with prescribed procedures of FHA Forms 2330 and 2330A. Careful review of the Forms is expected.

- a. If differences of opinion arise, due consideration should be given to the possibility that such differences stem from:
- (1) A genuine misunderstanding of HUD-FHA instructions;
  - (2) Honest differences of opinion clearly identifiable as such;  
or
  - (3) Other causes.
- b. If there is any reason to suspect that differences arise from causes other than cited in paragraph a.(1) and a. (2) above, Field Office Directors are required to request an audit, of the mortgagor's and/or contractor's books by the Director, Office of Audit before issuance of FHA Form 2580, Maximum Insurable Mortgage.

- 5-7. REVIEW OF COST FIGURES. Field Office Directors have the right and obligation to require clarification or breakdown of all or any part of the cost figures presented. This includes, but is not limited to, legal and organizational expense, general overhead, equipment rental, and the function of subcontractors or suppliers when such function is not already known to the office.

- a. When there has been a considerable lapse of time between initial occupancy and cut-off date for cost certification, there is the strong possibility that some items properly allocable to renting and operating the project will be charged against construction cost.
- b. It is recognized that it may not be possible or practical to make a precise allocation of such items as gas and electricity, clean-up costs, etc., as between operation and construction.
- c. Directors should insist on reasonable allocations and, of course,

should be on guard to detect and eliminate duplicate claims for the same expenses under both categories.

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5-8. DATE OF COMPLETION FOR DETERMINATION OF ACTUAL COSTS. The date of completion for the determination of actual costs will usually be the date on which the Director of Housing/HUD Representative endorses the final Project Inspection Report, Form FHA-2449, and HUD Representative's Trip Report, Form HUD-5379, showing 100 percent completion (which may be subject to acceptable items of delayed completion). However, to halt the unnecessary accumulation of certain costs, the Area Manager/ Service Office Supervisor may, at his/her option, set an earlier date as the date of completion when it is noted that although construction is 100 percent complete there is more than reasonable delay in obtaining or approving the final survey or, in projects nearly completed, there is unnecessary delay in achieving completion.

An illustration of the type of case in which the Area Manager/Service Office Supervisor is expected to set an early cut-off date for projects less than 100 percent complete would be one where the monthly inspection reports show 95% completion of work and thereafter show increases of less than 2% in percentage of completion in any three consecutive months.

5-9. REQUEST FOR SUBMISSION OF CERTIFICATION. The Area Manager/Service Office Supervisor will notify the mortgagor and mortgagee in writing, of the date of completion for determination of actual costs. He/she will request submission of cost certification within a time that he/she deems reasonable, and will include in his/her letter a statement that cost certification, properly documented, must be in field office hands 30 days before final closing. Copies of the letter are to be filed: one copy in the mortgagee section of the Washington docket, and one copy each in the Field Office docket and the Closing Attorney's file.

5-10. ALLOWABLE COSTS ON FORM FHA-2330.

a. Construction Contract:

(1) Where there is no identity of interest between sponsor/ mortgagor and general contractor, and a lump sum contract is permitted under HUD Regulations, the amount allowable is the lesser of:

(a) The actual cash paid under the contract (including amounts to be paid in cash within 45 days), or

(b) The contract price adjusted upward or downward by the cumulative effect of all construction changes approved by HUD:

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- (5-10) (2) Where there is an identity of interest between sponsor/mortgagor and general contractor, the amount allowable for construction is computed as shown in paragraph 5-11.

NOTE: If no construction contract was executed, the upset price for construction will be the total shown on line 51 of the approved Form FHA-2328, Contractor's and/or Mortgagor's Cost Breakdown, adjusted upward or downed by the net effect of the HUD-approved change orders.

b. Architect's Fee

- (1) The architect's fee is limited to the amount actually paid in cash for architectural services and no part thereof may accrue to the benefit of the mortgagor.
- (2) No portion of the architect's fee paid for in stock may be considered as part of the allowable costs.
- (3) In those instances where an identity of interest develops during construction, the total amount allowed as architect's fees may not exceed the amount set forth in the Agreement and Certification, Form FHA-3305/3305-A.
- (4) If the amount of the architect's design fee certified at cost certification is less than the amount set forth on Form FHA-2403-1, Mortgagor's and Architect's Certificate, submitted at initial endorsement, such differences cannot be used to offset overruns in other costs. Such differences must be applied as a direct reduction to the mortgage on line 1 of Form FHA-2580, Maximum Insurable Mortgage, and the Director of Housing notified of possible violations of the U.S. Criminal Code, Section 1010.

c. Reimbursement for Expenses Incurred in Early Start with HUD Approval.

- (1) A mortgagor may cost certify a reimbursement to the contractor for interest on money borrowed by the contractor for construction after issuance of commitment and prior to initial endorsement.
- (2) To induce the contractor to agree to an early construction start, the mortgagor may enter into an agreement with the contractor, subject to HUD approval, to reimburse the contractor for interest on money borrowed by the contractor for construction prior to initial endorsement. The

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(5-10) endorsement. The agreement must clearly state that reimbursement will be made only to the extent that the mortgagor has funds available from the amount estimated for interest during construction.

- (3) The amount of interest certifiable as cost is that amount

incurred by the builder for this purpose between the date construction started and the date the mortgage is initially endorsed for insurance. However, the rate of interest, so certifiable, may not be in excess of the rate established by HUD for the insured loan. The date of the start of construction must have been approved by HUD on Form FHA-2415 or Form FHA-3265 must have been executed.

- d. Interest. The interest allowable is the amount accrued on the first mortgage only, between initial endorsement (start of construction - Insurance Upon Completion) and a date 60 days after the HUD representative endorses the final HUD Representative's Trip Report, Form HUD-5379, showing 100 percent completion, which may be subject to acceptable items of delayed completion (or such earlier date as the Area Manager/Service Office Supervisor may \*  
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(5-10) or otherwise is not to be paid in cash, the "non-cash" amount is to be deducted from the accrued amount.

- e. Taxes: The amount of taxes allowable is the amount accrued during the same period used for (d) above, provided that the amount has been either; (1) paid in cash to the taxing authority or, (2) deposited in escrow with the mortgagee.
- f. Property and Casualty Insurance: The amount of property and casualty insurance allowable is the amount accrued during the period used in (d) above, provided that cash payment has been made to the insurer or cash has been escrowed with the mortgagee.
- g. FHA Mortgage Insurance Premium: Because the Office of Finance and Accounting cannot compute the exact amount of mortgage insurance premium due during the construction period until the project has been completed and the Washington docket forwarded to Washington, mortgage insurance premiums at 1/2 of 1% per annum on the mortgage amount will be allowed on the basis of accrual for the number of days in the period used in d., above, when applicable. \*
- h. HUD-FHA Fees: HUD-FHA application, commitment and inspection fees are allowable in the amounts paid. Fees paid to reopen an expired or terminated commitment are not includable in certified cost.
- i. Financing Expenses: Financing expense may include the "initial service charge" made by the construction lender, any discount charged by the construction lender and permanent lender, FNMA commitment fees, and in some cases brokerage fees. As to all of these, the maximum allowable is the lesser of: (1) the amount paid in cash or, (2) the amount shown on FHA Form 2434, Mortgagee's Certificate, and approved by the Field Office Director.

(1) It is required that, all other charges by the construction

lender, (except for construction loan discount, if any), including those classified as "processing fees," or expenses of lender's counsel" be included within the limit prescribed by the requirements of the Regulation's 2% of the mortgage amount. Processing fees, in excess of this limitation, if allowable at all in cost certification, are classifiable by HUD-FHA as part of Legal and Organization Expense and are discussed under that heading.

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- (5-10) (2) In insurance of advances, the interest rate recited in the mortgage and a reasonable discount on the construction loan is all that is allowable. Any "side deals" (except for approved discount) by which the mortgagor agrees to pay for "additional cost of money" are at the sole expense of the mortgagor and not includable in certified cost.
- (3) Any charges made by the lender for payment of counsel, or charges paid directly to the lender's counsel to the extent they cause the total to exceed 2% are not certifiable except insofar as they may be related to "Title and Recording" expense, in which case they should be so classified.
- (4) In any case where the permanent lender pays a premium for acquiring the permanent loan, any portion of such premium paid or credited to the mortgagor sponsor is to be treated as a recovery of cost for cost certification purposes.
- \* (5) Partial refunds of the commitment fee that were allowed in processing which are returned directly to the mortgagor will be treated as a recovery of cost.
- (6) The purchase of FNMA stock is not an allowable cost.
- (7) FNMA or GNMA extension fees paid covering a period of time beyond the cut off-date will not be allowed for cost certification purposes. \*
- j. Title and Recording Expense: Amounts paid in cash for title search and policy, and recording fees at the time of initial endorsement, updating of title policy during construction, and final title policy and recording charges are all allowable, as are cash legal fees paid in connection with any of the above.
- k. Legal and Organization Expenses: Legal and organizational expenses are those ordinarily incurred in organizing the mortgagor corporation, developing the proposal for submission to HUD-FHA and other necessary governmental agencies, and for necessary services during closings and construction.

- (5-10) (1) Organization expenses include necessary expenses customarily incurred by prudent, knowledgeable sponsors for reasonable

reimbursement for time devoted to the proposal, travel and communications, audit, and consultations in keeping with the complexity of the project.

- (2) Legal expenses are limited to those incurred for initial and final closings; tax advice during organization of mortgagor corporation only; and preparation of documents and representation for and during organization of the mortgagor corporation. Normally the allowed expenses include only those customary expenditures expected to be incurred prior to and during initial closing and construction (but including legal expense for final closing). (a) They will not include ground breaking ceremonies or entertainment. (b) Neither will they include the usual expenses connected with land acquisition already included in or contributing to the Title and Recording Expenses incurred in obtaining zoning. (c) Unavoidable additional legal and personal service expense may be incurred in connection with project land acquisition in urban renewal areas and a reasonable allowance may be made therefor, provided that the total of amount paid to the Local Public Authority and such additional expense does not exceed fair market value.
- (3) Care must be exercised to assure that Legal and Organization Expenses do not include any expenses intended to be paid from the Working Capital Deposit. A reasonable allowance may be included for advertising and promotional brochures.
- (4) Salaries of administrative and operating personnel etc., are not allowable. Such salaries would be recovered only from project income and to the extent funds are available after final endorsement would be chargeable against the Working Capital Deposit.
- (5) The mortgagor may wish to arrange a "package deal" for organization and/or legal services. Provided the supplier is qualified to furnish such services, the cost of such packages may be recognized (see Paragraph k(6)). A careful review is required, however, to insure that duplicate credit for the same service is not included.

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- (5-10) (6) The amount included in FHA Form 2264 for Legal and Organization Expenses is not a blanket allowance, but ordinarily sets an upper limit on the amount to be allowed. In extraordinary cases where this limit is exceeded, full documentation will be required as to reasonableness, purpose, necessity, and proper classification of all items included in this category. This limitation will be applied with extreme rigidity where a "package" is involved.
1. Off-Site Costs: The amount of a supplemental contract to which the mortgagor is a party in connection with off-site improvements is includable here. This, however, is not an allowable cost in the case of leasehold' estate in which the ground rent is based

on a land value which reflects off-site improvements and such improvements have not been paid for by the mortgagor.

m. Other: Allowable here are costs not provided for elsewhere in FHA Form 2330 and which are clearly attributable to actual cost of improvements on the mortgaged property up to the date of completion. The cost of topographic surveys, test borings, foundation investigations, or soils analysis, if not included in the architect's contract, is allowable in the amount actually paid.

- (1) Other installation charges for sewer and water, if not included in plumbing contract, may also be separated hereunder in the amount actually paid.
- (2) In case the land in the project is held by the mortgagor under a leasehold, an allowable item of cost to be reported by the mortgagor under this caption is the actual amount, if any, the mortgagor paid for acquisition of the leasehold. It is, however, subject to reduction by HUD-FHA so as not to exceed the HUD-FHA estimate of the fair market value of the leasehold. Unless precluded by Regulations, such as in Section 207 cases, ground rent paid during construction may also be included here.
- (3) In the case of rehabilitation projects, outstanding indebtedness on, purchase price of, land and improvements to be financed with part of the proceeds of the mortgage are also allowable in actual amounts paid, but are subject to HUD-FHA reduction so as not to exceed limitations of the Regulations and related Underwriting instructions.

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(5-10) n. Builder's and Sponsor's Profit and Risk Allowance: In those Sections of the National Housing Act where such an allowance is prescribed, the computation is as follows, and will be made without regard to amounts on FHA Form 2264:

- (1) Where there is an identity of interest between builder and mortgagor, and provided that no one subcontractor performs more than 50% of the HUD-FHA estimated cost of construction on FHA Form 2264, (exclusive of builder's fee general overhead, and architect's fee) and provided that no three or less subcontractors perform more than 75% of such, HUD-FHA estimated construction cost, a percentage is prescribed as agreed on FHA Form 3305 or FHA Form 3305A (not to exceed 10%) of all items entering into the term "actual cost" except land, amounts paid for the acquisition of a leasehold and any supplemental management funds allowed in processing.\*

NOTE: The division of the Profit and Risk allowance between mortgagor and sub contractor is a matter of no concern to HUD-FHA and any savings clauses or similar arrangements are also a matter of indifference to HUD-FHA provided that no

such arrangement will be allowed to operate to increase the amount allowable as Profit and Risk beyond 10% of the actual cost exclusive of land.

- (2) Where one contractor performs more than 50% of the HUD-FHA estimate of construction cost, or three or less contractors perform more than 75% of the HUD-FHA estimate of construction cost, the profit and risk allowance will be treated as if there were no identity of interest and computed as shown below.
- (3) Where there is no identity of interest between mortgagor and builder, the profit and risk allowance will be computed on the sum of:
  - (a) Allowable architectural fees,
  - (b) Allowable carrying charges and financing,
  - (c) Allowable legal and organization expenses, including consultant's fee, if such a fee was allowed in processing and,
  - (d) Allowable off-site costs.

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- (5-10) (4) The "50%-75% rule" as set forth above will not apply when factory built (including a temporary set-up on the site) modular units or components are involved in the construction of a project, since appropriate builder's fee is to be reflected in processing for this method of construction.
- o. Contractor's Fee--Profit Motivated Projects. Only where there is an identity of interest between contractor and mortgagor, where FHA Form 2330A is submitted, and where the Profit and Risk allowance is not applicable, will any amount be allowed for builder's profit. When all of the above conditions are met, the amount of builder's profit (not including general overhead, which is provided for in FHA Form 2330A) as shown on FHA Forms 2264 and 3305 or 3305A will be allowed whether or not paid in cash.
  - p. Occupancy During Construction Periods. If there has been occupancy during the period of construction, an operating statement is required.
- \* (1) The period covered shall be from first residential or commercial occupancy (or date of initial endorsement in \* rehabilitation of refinanced projects where occupancy is continuous) to the cutoff date for inclusion of interest, etc., as determined under the provisions of Paragraph 5-10.
  - \* (2) The operating statement must show gross rents including commercial income (not including security deposits) \* received during the period from first occupancy to the cutoff date and actual operating expenses during the same

period.

- (a) Operating expense, rental commissions customary for the type of project, if any, a reasonable management fee (not including salaries paid to officers of sponsor or mortgagor), and electricity, gas, water and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.,) are payable to the extent they are not already included in construction cost on FHA Form 2330 or 2330A.
- (b) Depreciation, interest, taxes, property insurance premiums, and mortgage insurance premiums are not to be included.

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- (c) If the operating statement produces an excess of Income over operating expense as defined, the excess shall be treated as a recovery of construction costs (line 15 of FHA Form 2330). A copy of the statement, signed by the mortgagor, must be attached to FHA Form 2330.
  - (d) If operating expense exceeds income, no entry shall be made on FHA Form 2330. As a matter of information, it is pointed out that in this latter case, the recognized excess of expense over income may be carried over as a reduction against the statement, if any, required by Paragraph 4-3a.
- (3) At the option of the mortgagor, the statement may cover the period from first occupancy to the last day of the month in which the final Inspection Report was signed. If this election is made, interest, taxes, insurance, and MIP will also be cut off as of the month-end date used for the statement.

5-11.ALLOWABLE COSTS IN FHA FORM 2330A. In any case where FHA Form 2330A is required, by reason of either (a) An identity of interest between mortgagor and contractor, or (b) Regulatory requirements applicable to nonprofit mortgagors, the Cost Analyst is required to review all costs of trade items, material purchase, equipment rental, general overhead, and job overhead. This review is expected to uncover and call attention to any major variances from reasonable market prices on an item by item basis. Although the review is not intended to be a cost audit, consideration should, at this stage, be given to the size and bargaining position of the general contractor and the determination as to what is reasonable should be made with those factors in mind. The determination must also take into consideration the time at which subcontracts, purchases, and leases were negotiated, as opposed to the time at which the cost estimation was prepared. If explanations of any cost items are needed for proper analysis, they should be requested immediately to avoid unnecessary delays. Reference 1 of the Foreword.

The Cost Analyst's comments and recommendations shall be reported on "memo" FHA Form 2331 and forwarded to the Director of Operations/Chief

Underwriter for his information and approval.

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- (5-11) a. Trade Items: Allowable costs under this heading will be the amounts paid in cash, or payable in cash within 45 days, to any subcontractor for the construction of on-site or off-site physical improvements after deducting any rebates, refunds, kickbacks, trade discounts, or price adjustments. When escrows are to be established for items of incomplete work, the full amount of the contract, as adjusted per above, shall be reported unless the subcontractor is cost-plus-fee with guaranteed upset price. In such cases the cost of the completed work plus the estimated cost of the completed work, or the upset price as adjusted by approved construction change orders relating to the trade item, whichever, is the lower, is allowed.
- b. Materials: Allowable amounts in this category may include the purchase price of any materials not included as part of a subcontractor's price, after deducting all rebates, kickbacks and discounts, but including any delivery and handling costs.

NOTE: If FHA Forms 3608 are required (see Paragraph 5-2), the amount of any subcontract, material purchase or equipment lease covered shall be subject to downward revision, at the sole discretion of the Field Office Director, to reflect actual going prices for the area. (See also requirement for submission of cost data under Paragraph 5-2.)

- c. Labor: Charges for labor will be limited to amounts actually paid.
- d. Escrow: The amount of any required escrow for incomplete items is not to be included at all if the incomplete work is the responsibility of a subcontractor or supplier whose price is already included under the appropriate section of FHA Forms 2330A. If it is clearly established that the cost of the completed work is not included elsewhere on the cost certification, the cost (not the required escrow amount) as estimated by HUD-FHA may be included and allowed. If significant amounts are involved, a supplemental statement of cost, as described in Paragraph 5-11, is required.
- e. Job Overhead: Allowable amounts for Job overhead cover such items as superintendents, field engineers to provide lines and grades for locating structures and utilities on the site, watchmen, temporary offices, telephones, supplies, temporary toilets, temporary heat for water and power during construction, cleaning, rubbish removal, and building permits. Other items may be approved by the Field Office Director provided they can properly be considered as part of job overhead for the project in question.

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- (5-11) (1) There shall not be allowed in job overhead any general

overhead of the contractor such as the salary of any person employed on a permanent basis and whose activities are in general confined to work performed in the main office or any established branch office of the builder.

- (2) The time spent on the actual construction of a project by a superintendent or foreman who is generally retained by the firm and who is assigned to a specific job or jobs for the purpose of coordinating the work may be charged to the cost of construction for that portion of such total employment as is actually applicable to the construction of the project in question.
- (3) Salaries of officers or executives of the contracting firm are allowable only if both of the following tests are met:
  - (a) The "executive" must have performed, during the period for which his salary is allowed, a type or types of duties which would normally be performed by a nonexecutive employee.
  - (b) Salary must be in line with the situation outlined in (a) above.

f. General Overhead: As stated in "e" above, no general overhead costs may be included under the "Job Overhead" classification. Under the provisions of the National Housing Act, however, for the purpose of determining actual cost as defined in Section 227 of the Act, there may be included in reimbursement for expenses paid "such allocations of general overhead items as are acceptable to the Assistant Secretary-FHA Commissioner."

- (1) Inasmuch as a contractor dealing at arm's length will include in his contract price an amount to cover both his estimate of general overhead expenses and profit, the FHA Regulations provide for the inclusion of general overhead only in cost-plus contracts.
- (2) The contractor may include in his certification of actual cost the amount allowed in processing with no itemization required by the general contractor.

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- (3) In Identity of Interest cases, however, general overhead may not exceed an amount estimated by underwriting processing, as stated in FHA Form 3305 or related forms. The amount allowed for general overhead shall relate to items outlined In Reference 1 of the Foreword.

g. The FHA Form 2331 "Memorandum" as completed by the cost analyst gives an opinion on all of the costs claimed on FHA Form 2330A. Upon receipt of this memorandum it will be the responsibility of the Mortgage Credit Staff to eliminate any portion of general overhead which exceeds the maximum as set forth in f., above. The

Mortgage Credit Staff is also responsible for adherence to the upset price as adjusted to reflect the HUD-FHA effect of approved construction changes. (Adjustments to upset price are made after all deletions to avoid doubly penalizing the contractor.)

5-12. ADJUSTMENTS FOR UNDETERMINED COSTS AND/OR ESCROWS. The statute requires that the mortgage shall not exceed the applicable percentage of actual costs. Consequently, FHA Forms 3305, and 3305A provide that where the Assistant Secretary-FHA Commissioner, for cost certification purposes, accepts estimates of cost for any item, and the later substitution of certified actual costs requires a reduction of the mortgage amount, the amount of such reduction will be paid to, or retained by, the mortgagee for application to reduction of the mortgage, or will be deposited in the Reserve Fund for Replacements. Such reductions of cost may arise from refunds, rebates, or discounts. The reductions also arise from the excess of escrows over the actual cost of incomplete construction items, refund of amounts deposited by the mortgagor to save the mortgagee from loss in connection with the sale of the mortgage (as set forth in Mortgagee's Certificate, or Request for Endorsement of Credit Instrument-Certificate of Mortgagee and Mortgagor) and any receipts from the settlement of claims against bonding companies or others which arose in connection with the completion of the project.

- a. Any prepayment required under this paragraph is to be considered mandatory and is to be applied to (1) scheduled monthly payments to principal to the extent possible, and (2) the Reserve for Replacements Fund.
- b. After required prepayment has been made the amortization schedule may then continue to be used for servicing the mortgage.

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- c. These mandatory payments are in addition to and not in lieu of regular monthly payments to principal or to the Reserve for Replacement Fund. There will be no adjustment in the amount of the annual MIP due on the mortgage resulting from the application of these mandatory prepayments to principal.
- d. When cost certifications are reviewed, the Field Office Director, shall determine the estimated items, if any, and whether or not the mortgagor or contractor has any claims in process or contemplated which might affect the actual cost. At this time the director shall establish an appropriate follow-up system for obtaining supplemental certifications of the actual cost of each item.

5-13. PREPARATION OF FHA FORM 2331. Field office cost sections are to proceed with processing and will prepare FHA Form 2331 "memorandum following the instructions in Paragraph 5-12. Working papers in connection with this processing will be retained.

5-14. REVIEW OF FHA FORM 2330. The mortgage credit staff is to perform its examination of costs for interest, taxes, HUD-FHA fees, financing, and legal and organization costs. If review of FHA Form 2330 reveals that

any construction costs are included in "Miscellaneous and "Other" categories, the cost section is to be so advised by memorandum.

5-15. IDENTITIES OF INTEREST. In connection with the identities of interest it may be well to cite three paragraphs which bear on this point:

- a. Paragraph 5-2 requires written reconfirmation of non-identity of interest between the mortgagor and contractor at the time of cost certification and also requires a statement from the mortgagor as to any identity of interest between the mortgagor and any subcontractor, material supplier, or equipment lessor.
- b. Paragraph 5-11 provides that any sub contract, material purchase, or equipment lease for which FHA Forms 3608 are required are subject to downward revision at the sole discretion of the Field Office Director.
- c. Paragraph 5-2c requires that in most cases subcontractors, suppliers or lessors must certify to their costs

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- (5-15)d. As to "a" above, It should be made clear that, if any identity of interest exists between mortgagor and general contractor, any subcontractor, supplier or equipment lessor having an identity with the general contractor is considered as having an identity with the mortgagor.
- e. As to "c" above, a downward revision will have to be made in any case where the parties fail to establish that the amount of the subcontract, material purchase, or equipment lease was in line with the current prices without giving excessive weight to commitment estimates.
- f. Field Office Directors are required to obtain certification from identity of interest subcontractors, suppliers, or lessors unless this requirement has been waived in accordance with Paragraph 5-2c.

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