
CHAPTER 5. FINAL CLOSING, COMMITMENT FOR INSURANCE

5-1. OPERATION OF INVESTOR-SPONSOR PROJECTS PRIOR TO SALE TO COOPERATIVE.

- a. Statement re Status of Sales. It is contemplated that the Investor-Sponsor will sell the project to a management type cooperative having a membership equal to at least 97% of the housing units in the project. This ideally occurs immediately following final endorsement of the Investor-Sponsor mortgage. Where this objective is not ready to be accomplished at this point, the Investor-Sponsor shall furnish the Director with a statement reciting the efforts made to sell the project cooperatively, a list of approved cooperative subscribers, a list of the subscribers who desire to occupy the project as rental tenants of the Investor-Sponsor pending transfer of title, and his plans and prospects for consummating the sale.
- b. Occupancy By Subscribers on Rental Basis. If the Investor-Sponsor and the cooperative wish to permit occupancy by subscribers on a rental basis, there will be no objection from the HUD-FHA standpoint (provided the usual requisites for occupancy have been met) to an arrangement either prior to or after final endorsement of the Investor-Sponsor mortgage. This arrangement would allow subscribers, whose credit has been approved by HUD-FHA, to occupy, as interim rental tenants of the investor-sponsor, the units for which they have subscribed. Under such circumstances, the relationship of the Investor-Sponsor to the residents is one of landlord and tenant. The rental must be computed as though the project were 100% occupied by cooperative members, giving effect to debt service requirements, deposits and approved budget applicable thereto. The interim lease must be in substantial conformity with the Model Form of Interim Lease, FHA Form 3260. It will be permissible for the cooperative residents during such interim period to accrue their down payments on a monthly installment basis.

- 5-2. OCCUPANCY BY NON-SUBSCRIBER TENANTS. If the Field Office Director satisfies himself that every reasonable effort has been and is being made to achieve the requisite cooperative membership, he may in his discretion approve an arrangement as referred to in the Sales Agreement permitting non-subscriber tenants to occupy unsold units in the project as interim tenants at a monthly rental

computed as though the project were a Section 207 rental housing project. Under some circumstances, such action may be in the best interest of all concerned, particularly where cooperative sales are proceeding very slowly. Such leases must be in substantial conformity with FHA Form 3260. The term of such leases is subject to the approval of the Director, who will take into consideration renting customs in the area, the length of time the cooperative sales has been in effect, the speed with which cooperative sales have been effected, and any other factors which may be pertinent. The lease term should not be in excess of one year nor in excess of the time consummation of the cooperative sale can be reasonably expected.

5-3. DISPOSITION OF PROJECT INCOME.

- a. It is Required that during the period between initial and final endorsement for mortgage insurance and until two years after the date of the completion of the project or until acquisition of the project by a cooperative, whichever is earlier, the Corporation shall cause all net receipts to be deposited monthly under an escrow agreement approved by the Assistant Secretary-FHA Commissioner. "Net Receipts" means the amount by which the income of the project exceeds the expenditures for the operation and maintenance of the project, including debt service requirements and payments to the Reserve for Replacements. The Investor-Sponsor is required to submit monthly reports to the Field Office reflecting all income and disbursements. HUD Form 93211 may, with adaptations, be used for this purpose.
- b. It is not the Intent of this Provision to prevent the withdrawal of net receipts deposited in earlier months of operation to meet legitimate, HUD-FHA-approved operating expenses in later months. For example, operating expenses running from initial occupancy in May or June will not reflect heat and light costs that will be incurred in the winter months of operation which may produce seasonal operating deficits.
- c. When Operating Income is Received prior to Final Endorsement, the mortgagor will be required to apply a portion of this income against debt service costs to the extent hereinafter provided.

5-4. OPERATING EXPENSES.

- a. From the Gross Occupancy Income Received, it is proper for the Investor-Sponsor to make disbursements for those expenses which are properly attributable to operation and maintenance of the project.
- b. Costs for Materials and Labor used in the construction of the project may not be paid out of occupancy income.
- c. It may sometimes be Difficult to Distinguish in character or degree the items which should be attributable to construction cost and to project operation. Some costs would be encountered in either an occupied or unoccupied project; for example, heating, electricity, property insurance, watchmen, etc., although the amount might be affected. Some costs, such as management expense, are purely operational. The Field Office should satisfy itself that amounts claimed for operating costs as distinguished from construction costs are properly supported.

5-5. DEBT SERVICE PAYMENTS.

- a. Once Operating Income is Received, it is expected that the Investor-Sponsor mortgagor will apply a proper portion of this income to pay for interest, taxes, and hazard and mortgage insurance premiums included in project costs. HUD-FHA will not permit the use of mortgage proceeds when such income is available. In Investor-Sponsor cases, the cost certification, unlike other programs, serves a dual function: (1) it may serve to reduce the amount of the insurable mortgage as in the other programs; and (2) it establishes the ceiling price at which the project may be sold by the Investor-Sponsor to the purchasing cooperative. Therefore, in order to be fair to the purchasing cooperative, debt service items, as described above, should be paid on a pro rata basis out of project income and mortgage proceeds. Needless to say, any items thus paid out of project income may not be included in cost certification. The ratio is established by dividing the actual rental income each month by the total potential rental income for the entire project. This means, for example, that if debt service costs for a particular month were \$3,000 and the income ratio was 1/10th of the potential, the Investor-Sponsor should pay \$300.00 out of occupancy income towards payment of these debt service items.

- b. The Requirement that a Portion of the Project Income must be used to pay for the Project Costs means that the certified cost of the project will be reduced. As pointed out above, HUD-FHA will not permit the cooperative to pay more than the certified cost of the project. This formula then may serve to reduce the cost of the project to the cooperative. There may, of course, be instances where the Investor-Sponsor has agreed to sell the project to the cooperative for a figure which proves to be less than his certified cost. HUD-FHA, of course, has no objection to his selling the project for a figure less than certified cost.
 - c. Where the Investor-Sponsor's Certified Costs, as Approved by HUD-FHA, are Higher than the Agreed Upon Sales Price, he can still be paid only the lower amount. Even the application of interim income against project costs might not in all cases reduce the actual cost to a point below the agreed upon sales figure. In such cases, the cooperative would not have profited by the interim income and the result would be to enable the Investor-Sponsor to recover a portion of his excess cost.
- 5-6. DISPOSITION OF PROJECT INCOME AFTER COMPLETION OF CONSTRUCTION. After the cut-off date for the inclusion of mortgage interest in cost certification or when the debt service items, as set up in the Building Loan Agreement, have been fully disbursed, whichever is earlier, occupancy income may be used in payment of both operating expenses and mortgage line items, and there is no requirement that they be prorated.
- 5-7. INABILITY TO CONSUMMATE COOPERATIVE SALE.
- a. In the event such sale is not consummated within two years after the date of completion of the project, the Investor-Sponsor will continue to own the project and it will continue to be insured under Section 213. However, it will thenceforth be operated as a rental project and be subject to the usual limitations applicable to HUD-FHA-insured rental projects.
 - b. It sometimes develops that, for reasons not anticipated at the time the commitment was issued, market acceptance on a cooperative basis fails to materialize. It may become clear before the two-year period has expired that there is no reasonable likelihood of "cooperatizing" the project, and that the interest of all concerned including the Assistant Secretary-FHA Commissioner would be served by discontinuing

the sales effort and in lieu thereof confining operations henceforth to a "straight rental" basis. When requests of this nature are received by the Director, he should forward same to the Office of Underwriting Standards accompanied by his analysis and recommendations.

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5-8. QUALIFICATION OF INVESTOR-SPONSOR TO PARTICIPATE IN FUTURE PROJECTS.

a. The Section 213 legislation provides that where an Investor-Sponsor fails to effect sale to a cooperative within the two-year period, the Assistant Secretary-FHA Commissioner is authorized to refuse, for such period of time as he shall deem appropriate under the circumstances, to insure under this section any additional Investor-Sponsor type mortgage loans made to such mortgagor or to any other Investor-Sponsor mortgagor where, in the determination of the Assistant Secretary-FHA Commissioner, any of its stockholders were identified with such mortgagor.

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b. To comply with this provision, the Field Office Director should notify the Office of Underwriting Standards of any situation where, in his opinion, such failure was due to a lack of good faith on the part of the Investor-Sponsor. In forwarding his report on this subject, the Director should indicate the name of the Investor-Sponsor, entity or entities, and all individuals associated therewith.

5-9. APPLICATION FOR INSURANCE OF ADVANCE OF MORTGAGE PROCEEDS (FHA FORM 2403).

a. This is the same form used during the course of construction for the advance of mortgage proceeds. When the final advance is in order, the mortgagee, the mortgagor, the contractor, and the architect will execute the completed form, and the form will be submitted by the mortgagee in triplicate. The form shall be accompanied by: (1) a completed Contractor's Requisition, FHA Form 2448; (2) Contractor's Prevailing Wage Certificate, FHA Form 2403-A; and (3) a final survey.

b. The survey accompanying this request must show the exact location of all buildings, water, sewer, gas and electric mains, and all easements for such utilities then existing. It must be prepared by a licensed surveyor who must certify that the project is installed and erected entirely on the

land covered by the insured mortgage and within the building restriction lines, if any, on said land, and does not overhang or encroach upon any easement or right-of-way of others.

- c. Further instructions regarding the completion of this form may be found in Reference (2) of the Foreword.

5-10. COST CERTIFICATION.

- a. In Investor-Sponsor Cases, the cost certification, unlike other programs, serves a dual function: (1) it may serve to reduce the amount of the insurable mortgage as in other programs; and (2) it establishes the ceiling price at which the project may be sold by the Investor-Sponsor to the purchasing cooperative when added to HUD-FHA's "as is" value of land.
- b. Once Operating Income is Received, the Investor-Sponsor is required to apply a portion of this income to pay for mortgage interest, taxes, and hazard and mortgage insurance premiums, included in project cost. Any items thus paid out of project income may not be included in cost certification. Consequently, a careful review of the items must be made to eliminate any duplication of the charges.
- c. The Treatment of Operating Income is discussed in some detail in the preceding paragraphs as it relates to the ultimate maximum sale price to the cooperative entity and the disposition of project income after completion. Review of the broader discussion will be helpful in determining the portion of project income that shall apply in reduction of project costs to the cooperative.