
CHAPTER 3. INITIAL SERVICING

- 3-1. Transfer of Control of a Project From Housing Development to Housing Management. In order to appreciate the larger picture involved in the life cycle of projects with HUD-insured or HUD-held mortgages, it is helpful to take a step back and retrace some of the major steps leading up from the Development side. Although Housing Development takes the lead in the areas discussed below (unless otherwise noted), Housing Management is involved in the process prior to the actual point of transfer of records. Specifically, Loan Management becomes involved in project operations at initial occupancy
- A. All too often staffs from the respective sides of Housing are so pressed with their own responsibilities and functions that work become compartmentalized. More understanding is needed of the "overall process." It is important to minimize any potential impact on owners/sponsors and to keep the process orderly. The transfer of control of project files is an internal administrative task and should have no bearing on owners/sponsors, who are more interested in the progress of their project's development than in the organizational make-up of the Department's staff.
 - B. Steps from Preparing for Initial Closing to commencement of Construction. Steps required to move a project to Initial Closing Include:
 - 1. Conducting the pre-construction conference;
 - 2. Collecting all closing documents;
 - 3. Approval of the closing documents by the Field Office Manager and Chief Counsel;
 - 4. Distributing initial construction advances or fees.
- NOTE: For a complete discussion of these procedures, see (a) HUD Handbook 4571.1 REV-2, Section 202 Direct Loan Program for Housing for the Elderly or Handicapped Processing Handbook, Chapter 7, (b) Handbook 4470.1 REV-2, Mortgage Credit Analysis for

Project mortgage Insurance, Section 207, and (c) Handbook 4430.1 REV-I, Initial Endorsement for Insured Project Mortgages.

C. Steps from Initiation of Construction to Final Closing. The steps involved in moving the project through construction to final closing of the mortgage or final endorsement for mortgage insurance include:

1. Disbursement of loan proceeds;
2. Monitoring construction progress;
3. Final inspection;
4. Pre-cost certification conference;
5. Cost certification;
6. Determining a maximum loan amount or a maximum insurable mortgage amount (Form FHA 2580);
7. Pre-occupancy conference (Housing Management function).

NOTE: For a detailed description of these procedures, see (a) HUD Handbook 4571.1 REV-2, Section 202 Direct Loan Program for Housing for the Elderly or Handicapped, Chapter 8, (b) Handbook 4470.1 REV-2, Mortgage Credit Analysis for Project Mortgage Insurance Section 207, and (c) Handbook 4435.1 REV-1, Project Construction and Servicing prior to Final Closing.

D. Transfer of Control of Project Records From Housing Development to Loan Management. The actual point of transfer occurs at Final Endorsement. The transfer is accomplished through the preparation of the Field Office Docket and its transmittal to the Director, Housing Management Division. For a breakdown of relevant procedures in this area, refer to Handbook 4350.1, Chapter 2, paragraph 2-2 (A) (2). From this point on, the

staff of the Loan Management Branch is responsible for monitoring project operations, occupancy, management and loan servicing.

- 3-2. Records and Files. HUD has an interest, either as mortgagee or as insurer of the mortgage, in a diverse portfolio of properties. In order to successfully service these projects, Loan Management Branch staff must maintain current information on their operations and condition.
- A. Foreword. Previous instructions, which limited project files to a specific number of folders and even specified particular supplies to be used when creating folders (in order to promote uniform recording and filing practices among Field Offices), are no longer practical and, therefore, have been eliminated from this update. Field Offices are afforded a certain degree of flexibility to design means that best suit their purposes provided that high standards of integrity are maintained regarding office filing systems. Project information must be filed promptly and readily available. Project files are to be maintained in a prudent, business-like and logical manner.
1. Headquarters encourages Field Office automation of filing systems. Some Field Offices are transferring dockets and files to microfiche as a way of saving valuable drawer space. Whether this system is adopted or traditional paper files are used, all disks, records and files pertaining to a particular project should be kept together and stored in one place.
 2. The mortgage servicing file for each project starts with "carryover" documents copied from the Field Office Docket (see paragraph 3-2(b-3) for contents) and current financial statements (see paragraph 3-2(b-4) for information on the financial analysis folder), and the body of files continues to grow during the life of the mortgage.
 3. Headquarters recommends supplementing the basic initiating files above with "special purpose files" that cover specific technical areas of operation including, but not limited

to, excess income reports if applicable, rent increases, certification/recertification 50059 forms, physical inspections, management reviews, mandatory meals and pet files for housing projects for the elderly or handicapped, letters from residents, etc. Separate files should be created for workout or modification agreements, default records, etc. Lastly, NOFA applications for Loan Management Set-Aside (LMSA) and Flexible Subsidy, which have specified retention requirements, should also be kept with the project files.

4. Information in project files should be filed in chronological order. Unless otherwise specified in outstanding instructions, records accumulated in working files may be purged every three years.
- B. General Asset Management File a/k/a Project Mortgage Servicing file. This is a file series that contains all documents, forms, reports and correspondence needed for prompt and correct servicing of a project. Each HUD-insured or HUD-held mortgage will have its own file comprised of a group of folders. Each file will initially contain copies of selected documents from the field Office Docket for that mortgage. To this nucleus of documents, Loan Management Branch staff will add additional records accumulated through servicing operations over the life of the mortgage.
1. Description of File. The General Asset Management File consists of the following:
 - a. General Mortgage Servicing Folder(s);
 - b. Financial Analysis Folder(s).
 2. Instructions. Subsection 3-2 (B) (3) (a) below lists the documents that are to be copied from the Field Office Docket and placed in the General Mortgage Servicing Folder. This procedure is to be followed for each mortgage. Loan Management staff may transfer extra copies of additional forms from the Field Office Docket, although this

is seldom necessary. Transfers of additional documents shall be done only if careful analysis indicates the documents are required for servicing operations over the life of the mortgage. Except for the construction guarantee inspection reports, do not include construction documents (records regarding the construction guarantee, completion of on and off-site items, disbursement of escrowed funds, minimum wage compliance, etc.) in the mortgage Servicing File. Such records pertain solely to construction matters or the mortgage insurance transaction, and should be transferred to the Federal Records Center for proper storage. See Handbook 225.6 REV-I, HUD Records Disposition Schedules.

3. Contents: General Mortgage Servicing Folder(s).
 - A. From Field Office Docket or other forms completed at the time of transfer from HD to HM. File the documents in relation to frequency of use. Thus, place seldom used documents, such as the mortgage, on the bottom and frequently referenced documents, such as the Replacement Reserve Breakdown or the Regulatory Agreement, on the top.
 - (1) Regulatory Agreement
 - (2) Rental Schedule, Form [HUD 92458](#) (the original schedule)
 - (3) Amortization Schedule
 - (4) Project Income Analysis and Appraisal, appropriate forms of the Form FHA-2264 series
 - (5) Request for Endorsement of Credit Instrument - Certificate of Mortgagee and Mortgagor, Form FHA 2455 (Insurance Upon Completion)
 - (6) Mortgagee's Certificate Form FHA 2434

- (7) Mortgagor's Certificate, Form FHA 2433
- (8) Request for Final Endorsement of Credit Instrument, Form FHA-2023 (Insurance of Advances)
- (9) Final Firm Commitment
- (10) Ground Lease, in leasehold cases only
- (11) Chattel Security Instrument, if any (Chattel Mortgage or Uniform Commercial Code Security Agreement and Financing Statement)
- (12) Mortgage or Deed of Trust Note or Bond
- (13) Mortgage or Deed of Trust
- (14) Other relevant forms or documents not found in the Field Office Docket, including the Housing Assistance Payments Contract (HAP).

B. In addition to the above documents the General Mortgage Servicing Folder(s) will contain additional records listed below which may be accumulated during servicing of the mortgage. These records include but are not limited to:

- (1) Physical Inspection Reports: HUD Reports: 9th and 12th month construction guarantee reports and annual mortgagee reports;
- (2) Rental Records for rent increases, rental computation forms and revised rental schedules;
- (3) Replacement Reserve Account: Withdrawal requests and approvals;
- (4) Mortgage servicing correspondence;

- (5) Other important reports, forms and documents, including occupancy reports, default records, modification agreements, work-out arrangements, Management Agent Profile and Certification (See Handbook 4381.5), etc.
 4. Contents: Financial Analysis Folder. Annual financial statements, submitted by mortgagor entities, filed in chronological order. Eventually, after an appropriate retention period, permission will be given to transfer them to the Regional Federal Records Center. (See Handbook 2225.6, HUD Records Disposition Schedules.) In addition to the items specified in paragraph 3-4(A) (1) below, the financial analysis folder(s) should also include supplemental information such as applicable schedules as required (income and operating expense, net income and disbursements analyses) and correspondence pertaining to financial statements and analysis.
- 3-3. Records Retention and Disposition. HUD has established schedules for the disposition of HUD records. For a complete listing of these disposition schedules, see HUD Handbook 2225.6 REV-I, HUD Records Disposition Schedules.
- 3-4. HUD Financial Requirements for Mortgages. Financial Reporting requirements imposed upon mortgagors are described in the regulations, Regulatory Agreement and Housing Assistance Payments Contract.
- A. Annual Audited Financial Statements. Mortgagors must submit (in accordance with specific regulatory agreement requirements) annual audited financial statements, and supplemental data reports, as well as an independent auditor's report on the mortgagor's internal control structure and a report on compliance.
 1. Required annual financial statements include:
 - a. Balance Sheet;
 - b. Statement of Profit and Loss (Form HUD-92410);
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- c. Statement of Surplus Cash or Residual Receipts;
- d. Statement of Changes in Partner's Equity;
- e. Statement of Cash Flows;
- f. Notes to Financial Statements.

NOTE: See HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects.

- B. Other Financial Requirements. Additional requirements imposed upon mortgagors may include (depending on the type of subsidy):
 - 1. Monthly Excess Income Reports for Section 236 projects;
 - 2. Quarterly performance report for projects receiving flexible subsidy, or under modification, workouts, etc.;
 - 3. Annual Operating Budgets.
- C. Books and Accounts. Mortgagors must also maintain and make available to HUD all books and accounts in accordance with HUD requirements as specified in HUD Handbook 4370.2, Financial Operations and Accounting Procedures for Insured Multifamily Projects.
- D. Submission of Financial Statements.
 - 1. Mortgagor Submission Requirements. The mortgagor must submit its annual financial statements to HUD within 60 days following the end of its fiscal year. Loan Management staff must take all measures necessary to obtain mortgagor financial statements on a timely basis. Loan management staff shall establish appropriate follow-up procedures to

insure prompt communication with mortgagors who are delinquent in submitting financial statements.

2. Importance of Financial Statements. Loan Management staff must impress upon the mortgagor the importance of timely submission of financial statements to HUD. Timely financial information is essential to the proper servicing of the mortgage loan. When mortgagors submit financial statements on time, the Field Office can process modification agreements, rent increases, etc., expeditiously. Also, timely financial information is essential to the proper servicing of the mortgage loan. When mortgagors submit financial statements on time, the Field Office can process modification agreements, rent increases, etc., expeditiously. Also, timely financial information enables the Field Office to address impending problems before they threaten the viability of the project. If the Field Office is firm regarding timely submission of financial statements, then the mortgagor will tend to comply.

 3. Failure to Furnish Annual Financial Statements. The Chief, Loan Management Branch, over the signature of the Director, Housing Management Division, shall inform mortgagors delinquent in submitting Annual Financial Statements that failure to furnish these statements constitutes a violation of the Regulatory Agreement or Charter for the project. The notice shall also inform the mortgagor that unless it submits the delinquent reports promptly, HUD may initiate an examination of the mortgagor's accounts and records or exercise the rights that accrue to HUD as a result of the mortgagor's failure to comply with financial reporting requirements (see Chapter 5 of this Handbook). If financial reports are not submitted on time, it will cause excessive delays in HUD processing of modification agreements, rent increases, etc. Until the required reports are submitted, the Chief, Loan Management Branch, through the Director, Housing Management Division, shall not
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consider requests for withdrawal of funds from the Reserve Fund for Replacements or for any concessions about mortgage requirements. Such concessions include, but are not limited to modification agreements, rent increases, etc.

4. Failure to Secure Financial Statements. If the Chief, Loan Management Branch, and Director, Housing Management Division, are not able to secure the financial statements, the Field Office Manager may issue requirements for compliance and impose sanctions, including, but not limited to:
 - a. Discussion of the future participation of the owner in HUD-insured programs;
 - b. For Section 236 properties, HUD retention of interest subsidy payments;
 - c. HUD Retention of Rent Supplement payments from projects that benefit from that subsidy;
 - d. Exploring the feasibility of requesting the mortgagee to accelerate the loan, assign the mortgage to HUD and then to determine the legal ramifications of instituting foreclosure proceedings as a result of this technical default;
 - e. Requesting authorization to pursue legal entitlement to possession under the provisions under the Regulatory Agreement or the mortgage, as appropriate.
- E. Extension of Time to Furnish Reports. The Chief, Loan Management Branch is authorized to approve extensions of time for submitting financial statements. In considering requests for extensions, the Chief shall be guided by the general principle that the usefulness of required statements diminishes as the delay in submitting them increases. This is especially true in cases of subsidized projects that are required to make annual deposits to a Residual Receipts Account. Delays may result in cash not being available once the amount of the required deposit is determined.

- 3-5. Post-Construction Activities.
- A. After Final Closing or Final Endorsement for Mortgage Insurance, Loan Management staff may need to perform certain carryover duties from the construction period. When the 9th and 12th month inspections occur before final endorsement, Housing Development staff should provide the lead regarding the protection and enforcement of the construction guarantee. See Handbook 4435.1 (revised edition), Construction Period to Final Closing for Project Mortgage Insurance, for specific guidance on guarantee inspections and follow-up with the various parties.
 - B. However, when the 9th and 12th month inspections are due after Final Endorsement, Housing Management staff must accomplish the following tasks:
 - 1. Coordinate with the HUD architectural staff to assure that the 9th and 12th month guarantee inspections are made on a timely basis;
 - 2. Prepare a written notification to the mortgagor, mortgagee and the surety (if applicable), for the signature of the Director, Housing Management Division; (This notification shall describe the findings of the HUD inspector's guarantee inspection report.)
 - 3. Follow up on notices of latent defects in order to decide whether to release, extend or make a demand on the guaranty;
 - 4. Assure that items of deferred maintenance discovered during guarantee inspections are brought to the attention of the mortgagor for remedial action.
- 3-6. Additional Services. This section is applicable to rental projects and does not apply to 221(d) SROs.
- Furniture, Equipment and Additional Services.
- A. Additional Services, offering of additional services not contemplated at initial processing, such as providing furniture, individual air
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conditioners, master television antennae, switchboard and package delivery services, etc., shall have the approval of the Director, Housing Management Division. If the mortgagor wishes to provide furnished dwelling units, and Loan Management staff determine that there is a demand for such accommodations, staff should encourage the mortgagor to make arrangements whereby the tenants can deal with an independent contractor directly for the furniture. If this can be arranged, the mortgagor would not participate directly in the furnishing of rental units, and therefore, no prior approval by HUD would be necessary. If this arrangement is not practical and the mortgagor undertakes to furnish dwelling units, HUD will not control the charges to tenants for furniture, provided the mortgagor submits a written agreement containing the precise language in Items 1 and 3 below, and specially adapted language to conform with Item 2.

1. The use of such facilities, and payment therefore by tenants, shall be completely voluntary on the part of the tenant and shall not be made a condition of occupancy. The tenant is to be informed as to the amount of shelter rent, and that amount shall be stated separately from all other charges.
2. The equipment or facilities to be installed or provided may be leased or purchased on installment contract, if outright ownership is impractical. If the equipment or facilities are owned by the mortgagor, they shall not be encumbered, sold or transferred without HUD consent. The mortgagor would be well advised not to commit itself to make any payments under an installment purchase contract in excess of the income derived from the use of the chattels covered by such a contract. HUD Form 2478, Mortgagor's Oath shall be executed if the mortgagor has not previously executed such a form or is not controlled by a Regulatory Agreement.
3. All income from these sources shall be deposited in the bank account of the mortgagor, and shall be properly recorded in its books and records.

- B. Approvals. Approval by the Director, Housing management Division shall be in writing, shall specify the number of units to be furnished (which should be no more than necessary to obtain satisfactory occupancy), and shall be contingent upon strict compliance by the mortgagor with the terms of the agreement. Installation of furniture is frequently associated with rentals on a transient basis. Field Offices will remain alert to detect such practices. If such activities are found, Loan Management staff shall advise the mortgagor in writing and demand that corrective action be taken.