
CHAPTER 6. FINAL ENDORSEMENT

- 6-1. INTRODUCTION. This Section covers matters arising in the period immediately prior to the "finalling out" of a loan involving insured advances during construction and also covers the actual final endorsement procedures. Instructions relating to cost certification and the cooperation of unsold Investor-Sponsor projects is included in Reference (9) of the Foreword. For the relationship between "initial" endorsement and "final" endorsement, see the first paragraph of Chapter 4 of this Handbook.
- 6-2. DOCUMENTS REQUIRED AT FINAL ENDORSEMENT. For the convenience of HUD personnel, as well as other parties to the transaction, a check list showing the documents required at final endorsement of a normal case has been issued as FHA Form 3257-G. To inform the parties of the documents which will be required in connection with final endorsement, this check list should be furnished to them upon request. In order that they may be advised as to specific requirements and the manner in which the requisite forms are to be filled in or modified to meet the HUD requirements pertaining to the type of loan involved, the parties may also be furnished with a copy of this Handbook.
- 6-3. TIMING OF FINAL ENDORSEMENT. After completion of construction, the next step is the final closing of the mortgage insurance transaction. A 30-day waiting period is stipulated in the Construction Contract and the Building Loan Agreement to allow time for clearance of liens. If, however, the mortgagee desires to close at an earlier date, and if the title company issues a title policy which is free of liens, closing may take place before expiration of the 30 days. Completion, for the purpose of final closing, means that: (1) the project has been completed in accordance with the drawings and specifications, except for approved items of delayed completion covered by an acceptable escrow agreement; and (2) the entire project has been accepted for occupancy by the local authorities having jurisdiction, by the lender, and by HUD.
- a. Upon the determination that an advance of mortgage funds will be the last advance prior to disbursement of the holdback (or at the time of substantial completion, whichever is earlier), preparation for final endorsement should begin. The Field Office will advise the Closing Attorney when the necessary preliminary determinations have been made and the Field Office will advise the mortgagor and mortgagee of the instruments and legal requirements necessary for final endorsement.

- b. Before endorsement can take place, the requirements hereinafter set forth must be complied with.
- 6-4. PROPERTY INSURANCE REQUIREMENTS. Before execution of the Application for Insurance of Advance of Mortgage Proceeds, FHA Form 2403, for a final advance, the HUD-FHA Director will ascertain from the ADTS/CU whether any changes in drawings and specifications or any appreciable change in the cost of construction of the project, have occurred during the course of construction which require a revision of Property Insurance Schedule, FHA Form 2329.
- a. If it is not Necessary to Revise the Previous FHA Form 2329, no action on the part of the HUD-FHA Director is required with respect to property insurance.
 - b. If a Revision of FHA Form 2329 is necessary, the HUD-FHA Director will obtain from the ADTS/CU revised and corrected copies of the form reflecting such changes and, at the time of execution of FHA Form 2403, will forward duplicate revised copies to the mortgagee with an appropriate letter notifying the mortgagee to substitute the revised copies (identifying such revised form by date) for the previous FHA Form 2329.
 - c. In all Cases of Revision of FHA Form 2329, or correspondence in connection therewith, copies of the revised form and correspondence will be filed in Washington and duplicate Dockets.
- 6-5. INCOMPLETE ON-SITE FACILITIES. It is desirable that all on-site construction be 100% complete before approval of a final advance of mortgage proceeds. However, circumstances may make it desirable that approval of final advance be given before 100% completion of on-site construction.
- a. Approval of a Final Advance Before 100% Completion of On-Site Construction. Such approval will be given only in cases in which minor items of on-site construction are incomplete and will be coupled with a requirement that funds be placed in escrow to assure completion of such items. Approval of a final advance of mortgage proceeds under such circumstances will be given only in those cases in which:
 - (1) All on-site items in the entire project are completed except those which qualify as items of delayed completion as set forth in underwriting architectural procedures;

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- (6-5) (2) All off-site utilities such as sewer, water, electrical, and gas facilities are installed and connected, and the

buildings are served by safe and adequate all-weather facilities, either permanent or temporary, for the ingress and egress of pedestrian and vehicular traffic, including fire apparatus, and all other provisions of the mortgage insurance contract have been acceptably accomplished or acceptably assured;

- (3) The ADTS/CU recommends that funds be placed in escrow for the completion of minor items because immediate completion is inadvisable or impossible due to weather or other conditions beyond control; and
 - (4) When the aggregated estimated cost of completing such items does not exceed 1% of the principal amount of the mortgage.
- b. In Order to Enhance Marketability and at the discretion of the HUD-FHA Director, an escrow may be established to cover the cost of final finishing interior painting of apartments without regard to the usual 1% limitation on escrows provided above. This is conditioned upon the builder being bound to complete all work covered by the approved plans and specifications within a fixed period of time not in excess of one year from the date of final endorsement for mortgage insurance and without any additional charge either to the mortgagor corporation or the incoming occupants.
- c. With Respect to Incomplete Items, except landscaping or other exterior improvements which cannot be completed because of the season, the amount held in escrow for completion must be at least twice the estimated cost of completion. In the case of landscaping, the amount held in escrow must not be less than the ADTS/CU's estimate of the cost of completion. The amount of any escrow shall be sufficient to assure an incentive to complete the work, taking into consideration a possible rise in cost. Such escrow will be held by the mortgagee, or under the control of the mortgagee, in accordance with the terms of Escrow Deposit Agreement, FHA Form 2456, and the HUD-FHA Director will ascertain that the items to be completed are properly identified by attachment to FHA Form 2403.

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- 6-6. INCOMPLETE OFF-SITE FACILITIES. A distinction is to be made between those cases in which the assurance of installation and completion of any off-site facilities is in the form of a cash escrow and those cases in which such assurance is in other form. The HUD-FHA Director will be guided by the following instructions;
- a. Cash Escrow. When the completion and installation of off-site facilities is assured by a cash escrow, and all off-site sewer,

water, electrical, and gas facilities are completely installed and connected, and other off-site facilities such as streets, walks, curbs, and gutters are incomplete but safe; and adequate facilities for ingress and egress are provided, approval of the final advance of mortgage proceeds may be given, but the HUD-FHA Director will require that the escrow agreement remain in force. The HUD-FHA Director, in such cases, will diligently pursue the completion of off-site facilities as assured by the escrow.

b. Other Forms of Assurance. In those cases in which the assurance of installation and completion of off-site facilities is in a form other than a cash escrow, the final advance of mortgage proceeds cannot be approved. Instead, the HUD-FHA Director will adhere to the provisions of the Building Loan Agreement and Construction Contract wherein it is provided that the 10% holdback will be retained until 100% completion of off-site facilities.

(1) If off-site utilities are completely installed and connected, and ingress and egress are provided, the request for the final advance may be treated as an ordinary application for advance of mortgage proceeds and may be approved in an amount which, when added to previous advances of mortgage proceeds, will equal 90% of the total advances to which the mortgagor will be entitled at 100% completion. In such cases, FHA Form 2403 will not be treated as approval of a final advance, nor will the submission of Request for Final Endorsement of Credit Instrument, FHA Form 2023, be in order. Instead, following 100% completion of all off-site facilities, the HUD-FHA Director will require submission of a new FHA Form 2403 for approval of the final advance, and subsequent submission of FHA Form 2023.

(2) In all such cases of incomplete off-site facilities, the HUD-FHA Director will endeavor to obtain completion at the earliest possible time.

(3) In any case in which the HUD-FHA Director feels that the retention of the entire 10% holdback is disproportionate to the cost of the off-site facilities to be completed, he may forward his recommendations for adjustment to the Office of Underwriting Standards.

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6-7. CHATTEL MORTGAGE OR ATTORNEY'S CERTIFICATE. Before final endorsement a chattel mortgage or chattel mortgage certificate must be submitted. The HUD-FHA Director will forward to the Closing Attorney a list of easily movable items, such as stoves,

refrigerators, hot water heaters, furniture, venetian blinds and other items of similar nature, purchased with mortgage proceeds. Identification of such items by serial number or brand name will be furnished where possible. The Closing Attorney will be responsible for securing either a chattel mortgage or certificate. The HUD-FHA Director will be responsible for furnishing the list * of easily movable items.

6-8. FINAL SURVEY OF PROPERTY. A survey is required, made after the erection of the building, and 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.

6-9. COST CERTIFICATION AS IT APPLIES TO COOPERATIVES.

a. Cost certification is applicable in Management, Investor and Non-Profit Sponsor Type cases. It is not applicable in Sales Type and Existing Construction cases. Reference (10) of the Foreword is applicable to cooperatives as modified by the following procedures:

- (1) Neither the signature of the mortgagor/contractor nor the accountant's certification operates to relieve the HUD-FHA Director from his responsibility to pass on the mathematical accuracy and the compliance with prescribed procedure of FHA Form 2330 and 2330-A. Careful review of the forms is expected. Differences of opinion may arise, and careful consideration should be given to the possibility that such differences stem from sources other

(6-9) than a genuine misunderstanding of the HUD-FHA instructions or honest differences of opinion. If there is any reason to suspect that differences arise from causes other than those cited above, HUD-FHA Directors are required to request an audit by the Office of the Inspector General of the mortgagor's and/or contractor's books before issuance of FHA Form 2580.

- (2) Field Office Directors have the right and obligation to require clarification or breakdown of all or any part of the cost figures presented, including, but not limited to legal and organizational expense, general overhead,

equipment rental, and the function of subcontractors or suppliers when such function is not already well known to his office. In projects where occupancy has been attained during the construction period, there is the possibility that some items properly allocable to operating the project will be claimed as construction costs. (i.e., the operation of Investor-Sponsor Projects prior to passage of title to the purchasing cooperative corporation.) It is expected that vigilance will be exercised by the HUD-FHA Director in order that misclassifications may be detected and corrected.

* (3) Supplemental statements, certified by an accountant in the same manner as the original statements, will be required for any estimated amounts included. *

b. Reimbursement of Contractor for Expenses Incurred in Consenting to an Early Start of Construction with HUD-FHA's Approval.

(1) To induce the contractor to agree to an early construction start, the mortgagor may enter into an agreement with the contractor, subject to HUD-FHA approval, to reimburse the contractor for interest on money borrowed by the contractor for construction prior to initial endorsement. The agreement must clearly state that reimbursement shall be made only to the extent that the mortgagor has funds available from the amount estimated for interest during construction.

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(6-9) (2) 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-FHA for the insured loan. The date of the start of construction must have been approved by HUD-FHA and FHA Form 2415 or 3265 must have been executed.

c. Legal, Organizational and Marketing Expense. Reasonable and necessary legal, organizational and marketing and development services expense incurred in the organization of the mortgagor, initial and final closing, and settlement of legal questions or litigation arising in connection with "organizing" the cooperative project are allowable. The expense in connection with "Organizing" the cooperative, includes the preparation of the formal documents for "Development of Mortgagor

Corporation." Solicitation for memberships normally involving the formation of a sales office, printing of brochures, education of members, advertising, equipping and furnishing of model units and lobby and other public spaces, salesmen's commissions, etc., is covered by the marketing allowance. However, insofar as furnishing of model units is concerned, there should be deducted from the cost thereof any salvage value of such equipment. Public space furnishings should remain the property of the cooperative. Each Handbook in the Cooperative Housing Series covering an approach to organizing cooperatives will contain more specific information concerning these fees.

- d. Two Legal and Organizational Expenses in Investor-Sponsor Cases. In Investor-Sponsor cases two legal and organizational expenses are involved and should be reflected in FHA Form 2330, namely, the expenses involving the mortgagor (Investor-Sponsor) and those involving the cooperative corporation formed to purchase the project. The Investor-Sponsor, in addition to constructing the project, has the statutory obligation to use his best efforts to sell the project to a cooperative and his expenses in doing so are therefore properly includable. As pointed out in Reference (9) of the Foreword, if before final endorsement the legal and organizational sum attributable to the cooperative has been exhausted by HUD-FHA-approved draws against same, the Investor-Sponsor may deposit additional

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- (6-9) sums with the mortgagee prior to final endorsement for application against further organizational expenses of the cooperative (as approved by HUD-FHA) and to the extent that such additional sums are used for this purpose with HUD-FHA approval they may be included in cost certification (See subsequent Section relating to adjustments for undetermined costs.)
- e. Occupancy During Construction Period in Investor-Sponsor Cases. The instructions in Reference (9) of the Foreword should be consulted with regard to the effect of occupancy income on cost certification.
- f. Care Required in Computing Costs of Investor-Sponsor. In Investor-Sponsor Projects, it should be borne in mind that the cost certification not only may affect the amount of the insurable mortgage but also sets the upper limit at which the project may be sold to the cooperative and, therefore, a careful computation of the costs is doubly important. The HUD-FHA Director will not approve release of any escrowed funds without a satisfactory certification of the actual cost of the performance of the work. These costs shall be

determined in accordance with instructions herein except that an accountant's certification will not be required.

- g. Occupancy During Construction Period in Management Type Cases. In some cases occupancy may be obtained before the cut-off date for inclusion of interest, taxes, mortgage insurance premium and property insurance premiums in certifiable cost. In these cases a statement shall be required showing: (1) gross occupancy income collected during the period from first occupancy to the cut-off date and; (2) actual operating expenses during the same period. Operating expenses for this purpose shall include advertising expense, sales commissions paid, a reasonable management fee, and electricity, gas, water, and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.) to the extent they are not properly included in construction costs on FHA Form 2330 and 2330-A. If this statement produces an excess of income over operating expense, the excess shall be treated as a recovery of construction costs and shall be entered on Line 15 of FHA Form 2330 and considered as a disallowance in Schedule 1, FHA Form 2580, under the caption "Recovery of Construction Cost - Net Income during Construction Period." As an alternative to the foregoing, the parties may at their option deposit the excess income in the Reserve for Replacements.

- (6-9) h. Review of Estimated Items. When cost certifications are reviewed, the Director will determine the estimated items, if any, and whether or not the mortgagor or contractor have any claims in process or contemplated which might affect the actual cost, and will establish an appropriate follow-up system for obtaining supplemental certifications of the actual cost of each item. Any payments on the mortgage required by these certifications will be considered as reductions in, but not as prepayments to, the insured mortgage.

This application of funds will not be required, however, unless the substitution of the actual costs for the amounts estimated in the original certification of costs would have required a reduction in the insured mortgage.

- i. Adjustments for Undetermined Cost. The mortgage must not exceed the applicable percentage of actual costs. Any reductions in estimated costs resulting from the settlement of escrows required for incomplete work or adjustments of costs estimated for the purposes of cost certification will be paid to or retained by the mortgagee for application to reduction of the mortgage or will be deposited in the Reserve

for Replacements. Such reductions of cost may arise from refunds, rebates, or discounts; the excess of escrows over the actual costs of incomplete construction items or legal and organizational expense; refund of amounts deposited by the mortgagor as set forth in Mortgagee's Certificate, or to save the mortgagee from loss in connection with the sale of the mortgage; and any receipts from the settlement of claims against bonding companies or others which arose in connection with the completion of the project.

- j. Determination of Maximum Insurable Mortgage. See underwriting instructions covering FHA Form 2580.
- k. Execution of FHA Form 2580. Upon execution of FHA Form 2580, the original will be forwarded to the mortgagee and an executed copy will be forwarded to the mortgagor. One copy will be placed in the Field Office Docket and one copy in the Washington Docket.

- l. Mortgage Adjustment Determination. When the supplemental certification is made of the actual cost of all items for which estimates were accepted at final endorsement, the Field Office Director will determine whether or not an adjustment in the mortgage amount is required. This determination will be made in accordance with paragraph 6-9.i., above. The Field Office Director will advise the mortgagee of his findings by a letter showing the basis of his computation. Copies of this letter will be forwarded to the mortgagor and to the Office of Underwriting Standards, for insertion in the Washington Docket. A copy will also be filed in the Field Office Docket.

6-10. EXCESS MORTGAGE PROCEEDS.

- a. There is a remote possibility that the cash paid out for completion of a project may be less than the mortgage proceeds. In such circumstances, the Director will require that any part of the mortgage proceeds which have not been expended to pay necessary costs of completing the project will be deposited in a special account of the mortgagor, from which disbursements may be made only with the prior written consent of the Assistant Secretary-FHA Commissioner. This requirement is stated in Paragraph (4) of the Agreement and Certification, FHA Form 3305. There will be no objection to the investment of such funds in obligations of, or full guaranteed as to principal by, the United States of America, or to their deposit in institutions whose accounts are insured by the United States. The establishment of the fund can be avoided

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- 6-11. APPLICATION FOR INSURANCE OF ADVANCE OF MORTGAGE PROCEEDS, FHA FORM 2403. 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; and (2) Contractor's Prevailing Wage Certificate, FHA Form 2403-A.
- a. If no Items of On-Site Construction are Incomplete, the office will type into the Certificate of Mortgage Insurance, on FHA Form 2403, in the space provided for the amount of the escrow deposit, the word "None." If items of on-site construction are incomplete and an escrow deposit is in order, attach to FHA Form 2403 an itemized list of incomplete items and type into the Certificate of Mortgage Insurance, in the space provided, the amount of the escrow deposit required for completion of incomplete items.
 - b. Following Execution of the Form, the Director will forward the original to the mortgagee, with attachments listing incomplete items, if any. An executed copy will be filed in the Washington Docket, and one copy will be forwarded to the ADTS/CU for use of the Mortgage Credit Section and eventual filing in the duplicate docket.
 - c. It is the Responsibility of the Mortgagee to submit, in accordance with the certificate of mortgage insurance, a completed Request for Final Endorsement of Credit Instrument, FHA Form 2023, with the credit instrument and any necessary escrow agreement. It is desirable, however, that the Director, in forwarding the completed form to the mortgagee, call to the mortgagee's attention such additional submissions as are required.
- 6-12. REQUEST FOR FINAL ENDORSEMENT OF CREDIT INSTRUMENT, FHA FORM 2023.

- a. After Receipt by the mortgagee of Approval of a Final Advance, this form, executed by the mortgagee and mortgagor, must be submitted in duplicate. This form should be modified by changing the final two paragraphs thereof to read as follows:

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- (6-12) (1) "Attached hereto is a current Financial Statement which accurately reflects the financial condition of the undersigned. The books and accounts of the undersigned have been and are being kept in accordance with the Uniform System of Accounts prescribed by the Secretary.
- (2) "The undersigned certifies that construction of the project is complete and that the lien securing the said mortgage is a good and valid first lien on the property therein described, that the mortgaged property is free and clear of all liens other than that of the subject mortgage, and that the undersigned does not have outstanding any unpaid obligations, except as follows:"

Except for Construction Items which are to be fully paid out of the final advance, in management and sales type cases, there should be no outstanding obligations other than the insured mortgage. This is also the case in investor-sponsored type cases except that non-negotiable notes are permissible as provided hereafter in this Handbook. (See Paragraph 6-13.)

- c. As to Items Shown on FHA Form 2023 as Unpaid Construction Costs, the Field Office Director may in his discretion require that an amount sufficient to pay all such costs be held by the mortgagee and disbursed under the supervision of the mortgagee to the subcontractor's materialmen, or other creditors to whom the sums included in this category are due.
- d. FHA Form 2023 should be Checked Against each Previously Approved FHA Form 2403 to determine that the date and amount of each advance are correctly stated and that the total shown on the FHA Form 2023 equals the total of all advances. If any error is found, the form will be returned to the mortgagee with an explanation of the correction required. (The inclusion of amounts advanced by the mortgagee to the mortgagor from escrow funds required for completion of the project is a common source of error, and it is important that such amounts be excluded from FHA Form 2023.)
- e. The Original of FHA Form 2023 will be filed in the Washington

6-13. MORTGAGOR'S INVESTMENT. The mortgagor's investment requirements are set forth in Reference (1) of the Foreword. The cost of the project to the mortgagor over and above the mortgage amount (after any reduction necessitated by cost certification) must have been fully paid. Deferred notes may be used in Investor-Sponsor cases provided they follow FHA Form 3249, Deferred Promissory Note. Deferred notes may not be used in Management Type cases except * with prior approval of the Office of Underwriting Standards.

6-14. WORKING CAPITAL.

- a. The Mortgagee shall collect from the mortgagor a Working Capital Deposit of not less than (2%) of the mortgage amount to be maintained and disbursed by the mortgagee during the course of construction to accruals for taxes, mortgage insurance premiums, property insurance premiums, and such other payments as may become necessary under the terms of the mortgage. Disbursements from this deposit may also be made for the purpose of defraying the mortgagor's expenses incidental to initial occupancy, such as purchase of office equipment and supplies, maintenance equipment, and administrative expenses. Commitments require that upon final endorsement, funds remaining in the deposit will be added to the Reserve For Replacement. Until such time as the commitment forms have been revised the remaining funds may, at the discretion of the Field Office Director, be deposited in the General Operating Reserve or the Special Working Capital Reserve Account No. 1315. (See Reference (11) or (12) of the Foreword.)
- b. In the case of Sales Type Projects, the Field Office Director will satisfy himself that disbursement of the balance of the working capital to the mortgagor for closing costs, or other purposes, will not have the effect of reducing the members' cash equity below that required by the HUD-FHA Regulations. *
- c. The Amount Required for Working Capital may be included in the required 3% down payment only if it has been paid to the mortgagor corporation by the members thereof.

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- 6-15. MANAGEMENT AGREEMENT. See background discussion under this heading in Chapter 4, Paragraph 4-35., of this Handbook. In management type cases, a Management Agreement must have been approved by the mortgagee and HUD-FHA prior to final endorsement. This should actually have been accomplished prior to occupancy.
- 6-16. PERMISSION TO OCCUPY. The permission to occupy procedure described in Chapter 5, "Construction Period" of this Handbook must have been complied with prior to final endorsement.
- 6-17. TITLE REQUIREMENTS. The title policy obtained at initial endorsement pursuant to the requirements set forth in Chapter 4 of this Handbook must be "brought down to date" showing coverage in the face amount of the loan, all in a manner satisfactory to the Closing Attorney.
- 6-18. EVIDENCE OF PUBLIC APPROVALS. To the extent that such approvals
* may not have been fully obtained in connection with the permission to occupy procedure, evidence satisfactory to the Field Office must be submitted to the effect that all buildings and utilities, on-site and off-site, have been installed and approved by all necessary governmental authorities and by the Board of Fire Underwriters. These items include, among other things, gas, electricity, water, sewerage, public streets, sidewalks and curbing.
- 6-19. MORTGAGOR'S ATTORNEY'S OPINION. The attorney should supplement his opinion submitted at initial endorsement (described in Chapter 4 of this Handbook) so as to bring it down to date to include the final endorsement.
- 6-20. COMMENCEMENT OF AMORTIZATION. Amortization will start on the date specified in the mortgage unless a deferment will have been recommended by the mortgagee and approved in advance by the Office of Underwriting Standards. *
- 6-21. ENDORSEMENT OF CREDIT INSTRUMENT.
- a. The credit instrument will be finally endorsed in an amount equal to the full amount of all insured advances to the mortgagor, as shown by the applicable FHA Form 2023, regardless of whether the final endorsement occurs before or after the commencement of amortization of the insured mortgage.
- b. The date of final endorsement will be the date the Director or his agent affixes his signature to the credit instrument.

6-22. ASSURANCE OF PERFORMANCE UNDER GUARANTEE.

- a. The Construction Contract contains a guarantee against latent defects and faulty workmanship and material for one year from date of completion. Alternatively, the guarantee may run from the date of substantial completion. Substantial completion means that: (1) the project has been completed in accordance with the drawings and specifications, except for approved items of delayed completion covered by an acceptable escrow agreement; (2) the entire project has been accepted for occupancy by the local authorities having jurisdiction and by the lender and HUD-FHA; and (3) the mortgage has been finally endorsed for insurance. The Director will be careful to avoid any action that might jeopardize the contractor's guarantee.
- b. If Completion Assurance Agreement, FHA Form 2450, was used at Initial Closing, the Director may, after final endorsement of the credit instrument, authorize the release of the escrow funds except for an amount equal to 2 1/2% of the total amount of the construction contract. The retained percentage will be held in the escrow account during the one-year guarantee period as specified in FHA Form 2450. The escrow provided for here is separate and apart from any escrow that may have been provided to assure completion of any incomplete construction items.
- c. If FHA Form 2452 or an AIA Bond were used, no action is required.

6-23. WASHINGTON DOCKET.

- a. Preparation of Washington Docket. Immediately on final endorsement of the credit instrument regardless of whether any funds are in escrow) the Director will require preparation of a permanent Washington Docket. The forms and documents to be filed in it and instructions for its preparation are given in Contents of Washington Docket, FHA Form 2471.
- b. Each Case Requires Individual Preparation of the Amortization Schedule by the Comptroller's office and also requires calculations in adjusting mortgage insurance premiums. The Comptroller's office is unable to prepare the amortization schedule or calculate the adjusted premium until receipt of the Washington Docket. Delays in handling these matters will result in misunderstanding on the part of mortgagees. It is necessary, therefore, that preparation and forwarding of the Washington Docket be expedited.

- (6-23) c. The Closing Attorney. immediately following preparation of the Washington Docket, it will be forwarded to the closing attorney. The closing attorney will check the Docket to determine that it contains the material required by FHA Form 2471 and to determine that the material is in proper legal form. On determination that the required contents are present and in proper form, the closing attorney will insert in the Docket his certificate stating that he has checked the Docket and that it complies with the requirements of FHA Form 2471. He will forward one copy of the certification to the Associate General Counsel for Housing Production, HUD, Washington, D.C., He will then forward the docket to the Office of the Comptroller, Washington, D.C., Attention: Multifamily Mortgage Branch, with a suitable letter of transmittal. One copy of the transmittal letter will be sent to the Field Office from which the Docket was received, and one copy to the Office of Underwriting Standards. The Office of the Comptroller will be responsible for recordation and safekeeping. *
- d. After Preparation of the Washington Docket, all remaining original and duplicate material, except that covered in Reference (13) of the Foreword will be filed in the Field Office Docket. The contents of the Field Office Docket are to remain in chronological order.
- e. A Master Set of Drawings and Specifications, and copies of all approved construction changes are not included in either Docket and should be handled as follows:
- (1) Hold in the Field Office until expiration of the one-year guarantee period under the construction contract.
 - (2) Then review for completeness and certify on FHA Form 2488.
 - (3) After review, integrate each set of plans, specifications and change orders in a tightly rolled bundle with the plans on the outside. Tie securely with twine at each end. Paste the FHA Form 2488 securely to one end of the roll.
 - (4) Forward to the regional Federal Records Center in accordance with Records Control Schedule, FHA 1, Item 5. This provides for reasonable accumulations, on a once-a-year basis. *

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- 6-24. MORTGAGE INCREASES, After initial endorsement, no increases in the mortgage amount may be permitted except with the prior approval of the Office of Underwriting Standards. Where a commitment for an increase has been so authorized, the procedure will normally involve the execution of a new mortgage in the amount of the increase, followed by an agreement consolidating both mortgages into one aggregate indebtedness.
- * 6-25. MORTGAGE INCREASE - TWO-YEAR OPERATION LOSS. Section 223(d) of the National Housing Act authorizes the Assistant Secretary - FHA Commissioner "in his discretion and under such terms and conditions as he may prescribe" to insure an increase in the mortgage to cover the excess of certain costs over project income "during the first two years following the date of completion of the project." It is expected that this provision will be availed of only rarely in cooperative housing cases and therefore no general instructions have been issued. Any specific proposals should be forwarded by the Field Office Director with his recommendations to the Office of Loan Management. *
- 6-26. CLOSING, INSURANCE UPON COMPLETION.
- a. Introduction. The preparation for closing instructions in Reference (13) of the Foreword are applicable except as to the applicable commitment forms. In insurance upon completion there will be no insured advances during construction nor will there be any "closing" involving the HUD-FHA until construction has been completed. Since the HUD-FHA has no insurance liability during the construction period, many of the HUD-FHA requirements which would be applicable to an insured advances project will not be involved.
 - b. Certificate of Mortgagee, FHA Form 3224 and Mortgagee's Certificate, FHA Form 3224-A. FHA Form 3224 must be accompanied by the contractor's Prevailing Wage Certificate, FHA Form 2403-A. FHA Form 3224-A is used in Existing Construction cases and by cooperatives purchasing an Investor Sponsored project under Section 213.
 - c. Property Insurance Requirements (Reference Chapter 5 of this Handbook.) The Director will ascertain whether the referenced instructions have been complied with. If they have not been complied with, he will immediately give the prescribed notice.

requires evidence that the work is covered by a guarantee against latent defects and faulty workmanship and materials. Performance under the guarantee will be assured by any of the following:

- (1) FHA Form 3259 Surety Bond Against Latent Defects, Defective Materials and/or Faulty Workmanship. The surety and the amount of the bond are the responsibility of the Director; the form and legal adequacy are the responsibility of the Closing Attorney. Any surety on the accredited list of the United States Treasury is acceptable.
 - (2) A cash escrow equal to 2 1/2% of the principal amount of the mortgage, to be retained in escrow by the mortgagee for a period of one year to assure correction of latent defects, faulty material and workmanship. Request for Endorsement of Credit Instrument - Certificate of Mortgagee, FHA Form 3224, contains a representation from the mortgagee that this 2 1/2% has been retained in such cases.
- e. Title Evidence. The instructions in Chapter 4, "Initial Endorsement" of this Handbook are applicable.
- f. Leaseholds. The instructions in Chapter 4 "Initial Endorsement" of this Handbook are applicable.
- g. Mortgagor's Certificate. The Mortgagor's Certificate, FHA Form 3218 is to be used except in Existing Construction cases not involving Secretary-approved repairs and cooperatives purchasing an Investor-Sponsor project under Section 213, where FHA Form 3218-A is used. The Field Office may in its discretion require an affidavit from such parties as the Director may indicate to the effect that all debts (other than the mortgage to be insured) have been paid. No outstanding obligations other than the insured mortgage should be permitted except with the approval of the Office of Underwriting Standards. *

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- (6-26) h. Basic Project mortgage Insurance Procedures Reference (13) of the Foreword, are applicable with regard to:
- (1) Incomplete On-Site Facilities.
 - (2) Incomplete Off-Site Facilities.

- (3) Public Approvals.
- (4) Special Conditions.
- (5) Credit Instruments.

i. Mortgage.

- (1) See Chapter 4 "Amortization Clause" of this Handbook, all of which is applicable except that the first sentence and the words "thereafter and" of the second sentence should be deleted from the quoted amortization clause.
- (2) The provisions relating to the Building Loan Agreement are normally deleted. The property description should be consistent with the plat attached as Exhibit "A" to the Commitment. In Sales Type cases, individual lot lines should be shown.
- (3) In insurance upon completion, several possible modes of procedure may obtain insofar as the nature of the construction financing is concerned. Under one approach, construction financing is obtained from a HUD-FHA approved lender using the HUD-FHA approved forms of Note and Mortgage. Another procedure (and this is the one which is most generally encountered) involves construction financing on conventional paper. Sometimes the sponsors are able to complete the project without construction financing of any kind. Any of these procedures is acceptable from the HUD-FHA standpoints but in any case the form of Note and Mortgage presented to HUD-FHA for endorsement must be in the prescribed form.
- (4) If the mortgage to be insured also served as the construction mortgage, evidence should be obtained to the effect that there are no existing defaults thereunder.

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(6-26) j. Chattel Mortgage or Attorney's Certificate. There are no exceptions to instructions (Reference (13) of the Foreword) other than the substitution of FHA Form 3224 for FHA Form 2434.

k. Organization of Mortgagor. The basic project insurance instructions cited above are not applicable. Development of the Mortgagor Corporation is covered in this Handbook.

(1) Certificate of Incorporation.

(a) Evidence Required. A certification is required from

the appropriate state corporate issuing official evidencing the filing of the Certificate of Incorporation in the form previously approved by HUD-FHA.

(b) Certificate of Domestication. In situations where the mortgagor has been incorporated in a "Foreign" state, there should be also furnished a certificate of domestication (sometimes known as a certificate of authority) by the appropriate official of the state in which the project is located.

(2) By-Laws. These must be duly certified and be in the form previously approved by the HUD-FHA.

- l. Survey Instructions and Certificate, FHA Form 2457. The survey must be a final survey and must be accompanied by the certificate of a licensed surveyor executed on Survey Instructions and Certificate, FHA Form 2457.
- m. Mortgagor's Resolutions Authorizing Mortgage Transaction. There are no exceptions to Reference (13) of the Foreword.
- n. Building Loan Agreement. It is unlikely that any building loan agreement will be involved. If one were executed, its provisions should have been fulfilled and no longer operative at the time of the HUD-FHA endorsement.
- o. Construction Contracts.

(1) "Lump Sum." There is no standard form, but the parties are required to have inserted the requisite prevailing wage provisions. The appropriate phraseology is to be found in Article 9 of the Construction Contract forms, FHA Form 2442 or 2442-A. The usual payment provisions may be altered to fit the situation.

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- (6-26) (2) "Cost Plus." A "Cost plus" contract is required in management type "identity of interest" cases. Therefore, in addition to prevailing wage provisions, this contract must contain the cost certification provisions stipulated in the Agreement and Certification, FHA Form 3305-A. The parties sometimes use the FHA insured advances Form 2442-A with the usual payment provisions altered to fit the situation.
- p. Evidence of Secretary's Beneficial Interest in Mortgagor. Where the Assistant Secretary-FHA Commissioner's control over the mortgagor corporation will be exercised by preferred stock,

the closing attorney will require delivery from the mortgagor of evidence of such interest and will deliver to the Director the appropriate document with his certificate that the form of the evidence conforms to the legal requirements of the applicable jurisdiction. On receipt, the Director will require execution of a stock purchase voucher and forward evidence of interest with the voucher to the Office of the Comptroller, Washington. The purchase price of such stock will be \$100.

q. Supervisory Architect's Agreement and Statement.

- (1) This is an agreement between an architect and the mortgagor corporation to provide supervisory service during the construction period. There is no FHA model form on the subject but the agreement must have been entered into prior to the commencement of construction and must contain the following clause:

"The undersigned architect hereby certifies that he does not represent any party or interest in connection with the above-referred-to housing project other than the mortgagor corporation and further certifies that he does not have any financial interest in the project or the real estate upon which it is to be constructed other than the fee he has received or is to receive from the mortgagor corporation."

- (2) This agreement should be accompanied by a receipt showing that the architect has been paid in full for his services and that in the opinion of said architect construction of the project has been completed in conformity with the plans and specifications.

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- (6-26) r. Sponsor's Certification, FHA Form 3227. Sponsor's Certification, FHA Form 3227, must be obtained at the time of closing. It is the Director's responsibility to determine, and inform the closing attorney as to the individual or individuals who are to execute this agreement. The purpose of this certification is to give assurance that all cooperative members listed have a bona fide intention to reside in the project.

s. Attorney's Comprehensive Opinion.

- (1) The mortgagor's attorney must submit at closing to the closing attorney, addressed to the mortgagee and to HUD-FHA, his comprehensive opinion as to the legality of the entire transaction and legality and adequacy of the

contractual instruments. The nature and scope of this opinion is the responsibility of the closing attorney.

- (2) It is required that the following statement be included in the attorney's opinion:
- (a) "The undersigned hereby certifies that he does not represent and has not represented any party or interest in connection with the above-referred-to housing project other than the mortgagor corporation, and further certifies that he does not have any financial interest in the project or the real estate upon which it is to be constructed other than the legal fee he has received from the mortgagor corporation."
 - (b) "The undersigned hereby acknowledges receipt in full of his fee for legal services in connection with the captioned project. The undersigned was retained by the mortgagor corporation prior to the commencement of construction and states that to the best of his knowledge, information and belief, the mortgagor is indebted to no other attorney for legal services."
 - (c) "All fees and charges necessary to continue the mortgagor corporation in existence for at least 1 year from the date hereof have been paid."

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- (6-26) t. Cost Certification. The instructions contained in Reference (10) of the Foreword are applicable to management type and investor-sponsor type projects except that identity of interest, in management type cases, is determined in accordance with Chapter 4 of this Handbook and, in investor-sponsor cases, Reference (14) of the Foreword.
- u. Determination of Maximum Insurable Mortgage. The instructions contained in Reference (13) of the Foreword are modified by excluding all references to advance amortization.
- v. Excess Mortgage Proceeds. The basic project insurance instructions cited above are applicable. FHA Form 3305-A will be used instead of FHA Form 3305. Any required referrals to Washington will be to the Office of Underwriting Standards.
- * w. Endorsement of Credit Instrument and Collection of First

Mortgage Insurance Premium. There are no exceptions to the basic project insurance instructions cited above.

- x. Distribution of Closing Documents. There are no exceptions to basic project insurance instructions cited above except that headquarters reference should be to the Office of Underwriting Standards. *
- y. Revision of Instruments. There are no exceptions to the basic project insurance instructions cited above except that headquarters reference should be to the Office of Underwriting Standards.
- z. List of Closing Instruments. For the convenience of HUD-FHA personnel as well as other parties to the transaction, the following check lists showing the documents required for endorsement of insurance upon completion loans have been issued:
 - (1) FHA Form 3257-D. This form is applicable to Management and Sales Type cases under Section 213 and replaces the form formerly set forth in the Manual.
 - (2) FHA Form 3257-E. This form is used in closing Existing Construction cases under Section 213(i) of the Act - where no advances for improvements are involved.

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- (6-26) (3) FHA Form 3257-F. This form is used at the endorsement of a loan to a cooperative corporation to enable it to purchase an Investor-Sponsored project. This is in effect an insurance upon completion transaction.