
14.1

Projects that Must Certify

Cost certification is required by the National Housing Act and Regulations for all insured multifamily projects processed by MAP Lenders except for rental projects insured under: Section 207/223(f) refinances where the mortgage is 80 percent or less of value.

14.2

Purpose for Certification

The purpose for certification is to establish the mortgagor's actual costs, including contractor's cost, to establish the "maximum insurable mortgage" for final endorsement of the insured mortgage.

14.3

Certifiable Costs

Certifiable costs are those costs that have been paid in cash or will be paid in cash within 45 days of final closing, except

- A. Land Value which will be calculated by HUD,
- B. General Overhead which is certifiable whether or not paid in cash, and
- C. BSPRA which is cost certifiable whether or not paid in cash, where there is an identity of interest between the mortgagor and contractor.
- D. Non-profit Developer's Fee which is cost certifiable whether or not paid in cash, less amounts certified to and allowed on other line items.

14.4

Types of Cost Certification

- A. Standard or "Long Form" Certification is required, except for projects permitted to use the "simplified" cost certification, and for certification of projects insured under Section 207 or Section 232 pursuant to Section 223(f).
- B. Simplified Certification is restricted to projects involving 40 or less units of proposed construction or substantial rehabilitation. Simplified Certification is used for Sections 207/223(f) and 232/223(f), regardless of size.
- C. Section 223(f) Certification is required for all projects insured under Section 207 or Section 232 pursuant to Section 223(f), except that certification is not required for Section 207/223(f) transactions, where the mortgage is 80 percent or less of value.
- D. Section 223(f) Supplemental Certification is required for projects identified in paragraph C above, where completion of repairs is permitted after closing

14.5**Entities That Must Cost Certify**

- A. Mortgagor must certify for all projects, except 207/223(f) refinances where the insured mortgage is 80 percent or less of value.
- B. Contractor must cost certify where:
 - 1. The Contractor has an identity of interest with the mortgagor, whether such identity of interest existed before the initial closing (for insured advances projects) or issuance of the Firm Commitment (for insurance upon completion projects), or the identity of interest developed after those dates; and/or
 - 2. The contractor used the Construction Contract-Cost Plus, Form HUD-92442A, whether or not any identity of interest with the mortgagor existed or came into being.
- C. Subcontractor at any tier, equipment lessor, material supplier, and manufacturer of industrialized housing must cost certify where:
 - 1. The total of all subcontracts, purchases and leases is more than .5 percent of the mortgage, and
 - 2. An identity of interest exists or comes into being between such subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing and either:
 - a. The mortgagor, or
 - b. The contractor, where the contractor must cost certify.

14.6**Sequence of Events**

- A. Notification of Pre-Cost Certification Conference. HUD must notify the mortgagee, mortgagor, and contractor when the project is 80 percent complete. HUD should notify new sponsors and general contractors earlier than 80 percent completion. The letter should state that:
1. The conference should be attended by the mortgagor, general contractor, their accountants, and the mortgagee.
 2. Enclose with the letter the 800 number or the Internet address for:
 - a. Handbook IG 2000.4, Consolidated Audit Guide for HUD Programs.
 - b. Four copies of each of the applicable forms:
 - (1) Form HUD-92330, Mortgagor's Certificate of Actual Cost.
 - (2) Form HUD-92330A, Contractor's Certificate of Actual Cost, if applicable.
- B. Conduct of Conference is the responsibility of the assigned HUD Staff and should be held before the project is 90 percent complete. At the conference HUD staff will explain:
1. Final completion, administrative completion, and cut off dates.
 2. Documentation required for cost certification including the income statement and balance sheet.
 3. Remind the mortgagor and accountant that they are responsible for computing the liquidated damages/actual damages and incentive portions, if applicable, of the construction contract using the certified amounts on HUD-92330.
 4. Necessity for a careful review and completeness of the documentation including dates and signatures, and timeliness of the submission, HUD review, and final endorsement.
 5. Any problems with prevailing wage certifications or other labor issues.
- C. Cut-off date established for computation of the cost certification.
- D. Submission and HUD approval of the cost certification must occur before final closing, except that the Section 223(f) supplemental cost certification is not required until completion of non-critical repairs deferred until after closing.
- E. Upon completion of the project, Form HUD-92464, Request for Approval of Advance of Escrow Funds should be prepared by the Lender and submitted to HUD for approval. The Lender does not approve (sign) this form on behalf of the Department.

14.7**Final Completion Date/Cut Off Date**

- A. Final completion date for determining actual costs is the date the HUD inspector signs the final HUD Representative's Trip Report, Form HUD-95379, provided that the trip report is subsequently endorsed by the Construction Manager. Construction must be complete, except for acceptable items of delayed completion. The mortgagor, general contractor, and mortgagee will be notified in writing of the final completion date.
1. The final completion date is the effective date for cost certification. However, the mortgagor has the option to include in the cost certification all soft costs incurred up to 60 days beyond this date. The date selected by the mortgagor is the "cut-off date" for the soft costs.
 2. The mortgagor's balance sheet and operating statement date must agree with the selected cut-off date.

14.8**Administrative Completion Date**

The Hub Director may advance the completion date to prevent unnecessary accumulation of soft costs. This is done when projects nearly completed, face unnecessary delay.

- A. The Hub Director may set an administrative completion date for any project when the monthly inspection reports show 95 percent completion of work and thereafter less than 2 percent increase in percentage of completion in any month.
- B. The Hub Director notifies the mortgagor, general contractor, and mortgagee in writing of the administrative completion date and the following:
1. The administrative completion date is the effective date for cost certification except that all soft costs up to 60 days beyond this date may be included at the option of the mortgagor.
 2. The date of the balance sheet and operating statement must be the same as the cut-off date selected by the mortgagor.
 3. Liquidated/actual damages for cost certification purposes will be computed using the administrative completion date. However, the general contractor is responsible for liquidated/actual damages through the date of final completion.
- C. Copies of the notification go to the Washington Docket, Office Docket, and Closing Attorney's file.

14.9**Submission Date**

Submission Date for cost certification should be within 30 to 45 days after the cut-off date and not less than 30 days before the desired final closing date.

14.10**Required Forms**

- A. Form HUD-92330, Mortgagor's Certificate of Actual Cost, and line by line instructions are contained in the Forms Appendix.
- B. Form HUD-92330A, Contractor's Certificate of Actual Cost, and line by line instructions are contained in the Forms Appendix. Also used by subcontractor, material supplier, industrialized housing manufacturer, or equipment lessor required to certify cost.

Note: When a project includes rehabilitation and new construction, a separate form is required for each, with a master form summarizing total project costs, including fees.

- C. Form FHA-2205A, Mortgagor's Certificate of Actual Cost (Section 207 Pursuant to Section 223(f)), and line by line instructions are contained in the Forms Appendix.

14.11**Required Statements and Certifications**

Follow either A or B, below, depending on qualifications in A.1.

- A. Simplified Form of Cost Certification. Use Forms HUD-92330, HUD-92330A (if a cost plus construction contract was used or an identity of interest exists between the mortgagor and the general contractor). An accountant's opinion is not needed.
 - 1. Simplified cost certification is permitted for new construction or substantial rehabilitation projects involving 40 units or less and for refinancing or purchase of existing properties under 207/223(f) and 232/223(f).
 - 2. If there is an identity of interest between a subcontractor, material supplier, equipment lessor, or manufacturer of industrialized housing and the mortgagor and/or general contractor who must cost certify, and the total of all identity of interest subcontracts, purchases and leases is more than 1/2 of 1 percent of the mortgage, the identified party uses Form HUD-92330A. This requirement established by the Agreement and Certification, Form HUD-3305/3306, applies in all cases.

3. An unaudited balance sheet of the mortgagor entity, as of the cut-off date is required in all cases. Format and content of the balance sheet must follow paragraphs B.4.a through g below.
 4. An unaudited operating statement is required if occupancy occurred during construction. Format and content of the operating statement must follow paragraphs B.5.a through c below.
 5. In those cases involving LIHTC's, the information must be audited even for those cases eligible to submit a simplified cost certification.
- B. Long Form Cost Certification. For cases that do not qualify for simplified cost certification based upon paragraph A.1 above, submit the following:
1. Mortgagor's Certificate of Actual Cost, Form HUD 92330, supported by an accountant's opinion (refer to paragraph 14.11 B6).
 2. Contractor's Certificate of Actual Cost, Form HUD-92330A, supported by an accountant's opinion (refer to paragraph 14.11.B.6), is required if there is an identity of interest with the mortgagor or if a cost plus construction contract was used.
 3. Subcontractors, suppliers, and equipment lessors with an identity of interest with either the mortgagor or general contractor must submit Form HUD 92330A supported by an accountant's opinion.
 - a. Material suppliers. Attach to Form HUD 92330A a sheet showing:
 - (1) Quantities furnished.
 - (2) Sources from which the materials were obtained.
 - (3) Unit prices paid to the sources, brand names, model numbers, sizes, lumber grades, etc., as applicable.

NOTE: No amount will be included for general requirements (job overhead).
 - b. Equipment Lessor. Attach to Form HUD 92330A a sheet showing:
 - (1) Dates the equipment was acquired,
 - (2) Age of equipment at acquisition date,
 - (3) Brand names and model numbers,
 - (4) Sizes,
 - (5) Dates and length of time used, and
 - (6) Rates charged.
 - (a) The Lessor(s) must certify that:

- (i) The rates charged were not more than the local going rate obtainable in the area, including any maintenance and repair.
 - (ii) The time charged was not more than essential for the project.
 - (iii) The charges did not exceed the purchase price of the equipment.
- (b) Lump Sum Basis. Instead of providing an attachment containing the above information, the lessor(s) may elect to certify to charges at 85 percent of the local going rates for identical equipment under arms' length (lump-sum) leases. When using this alternative, the lessor agrees:
- (i) The Hub is the sole judge of the reasonableness of the time and rates charged, and
 - (ii) Equipment maintenance and repair expense is the responsibility of the lessor(s) and is not included as an additional cost.
- (c) Subcontractor's equipment. Costs for subcontractor(s) equipment, whether owned or rented, are considered in the markup for overhead and profit. These costs shall be reflected in the total subcontract and in the prior approval of identity of interest entities. A separate certification of the equipment is not required.
- (d) Manufacturer of Industrialized Housing. Attach to Form HUD 92330A, a breakdown of Division 13, Special Construction, showing:
- (i) Manufacturing costs.
 - (a) Labor
 - (b) Materials
 - (c) Sales and any other taxes
 - (d) Factory overhead
 - (e) General overhead and profit
- NOTE: The manufacturer's accounting system must follow generally accepted accounting procedures which will allow certification of the actual cost of manufacturing by a Certified Public Accountant or Independent Public Accountant. No amount will be included for transportation or work at the project site.
- (ii) Transportation costs, factory to project site (if provided by manufacturer).
 - (a) Labor
 - (b) Equipment
 - (iii) On-site erection costs (if provided by manufacturer).
 - (a) Labor
 - (b) Equipment

(c) Materials

(d) General requirements (job overhead)

(iv) The remainder of the manufacturer's Form HUD 92330A is completed per outstanding instructions.

NOTE: There can be no duplication of manufacturing costs, i.e., repair of components damaged in shipment.

4. An audited balance sheet of the mortgagor entity, as of the cut-off date is required.

a. The balance sheet must contain the following certification

I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the mortgagor [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of _____ (Name of mortgagor or owner) financial position as of _____ (date of financial statement).

Signed this ____ day of _____, 20

_____ (Signature of authorized agent with name printed or typed under signature)

WARNING: HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18U.S.C. 1001, 1010, 1012; 31U.S.C. 3729, 3802)

b. Furnish reconciling information if short term liabilities on the balance sheet do not agree with Column B of Form HUD 92330.

c. Explain the purpose of all liabilities in the notes to the financial statements and include repayment requirements of the liabilities.

d. If proceeds and obligations from project syndication are passed through the books and records of the mortgagor entity, reflect receivables as an asset of the mortgagor entity.

e. The notes to the balance sheet must identify the original amount of and summarize the expenditures from the working capital deposit.

5. An audited operating statement is required if occupancy occurs before the cost certification cut-off date.

a. The statement must contain the certification contained in Paragraph 14.11.B.4.

b. Prepare the operating statement on an accrual basis.

c. The statement covers the beginning of marketing and rent-up activities (or date of initial endorsement in rehabilitation projects where occupancy is continuous) to the cut-off date.

d. Marketing and rent-up activities will start no earlier than 6 months before the issuance of the first Permission to Occupy-Project Mortgages, Form HUD-92485.

- e. The statement must show the actual dates covered rather than language such as "From the Date of Commencement of Marketing and Rent-up Activities, etc."
- f. The statement must show income from all sources. Do not consider security deposits as income.
- g. The operating statement should not contain any expense items that were paid or should have been paid from the working capital deposit or otherwise included in cost certification.
- h. Operating expenses may include:
 - (1) Expenses directly relating to renting the project, such as:
 - (a) Rental commissions customary for the type of project, if any, and
 - (b) Marketing and advertising expenses.
 - (2) Purchase of furnishings, equipment not paid from the working capital deposit, and supplies essential to project operation.
 - (3) Reasonable fees for preparing any Federal, State, or local tax return information required of the project.
 - (a) For example: If the mortgagor entity is a partnership, the cost of preparing both Form 1065, U.S. Partnership Return of Income, and related K Schedules may be considered. Do not recognize the cost of preparing a partner's personal Form 1040 return.
 - (b) If the project is owned by an individual, include the cost of preparing any tax return schedule related to project operations, but not other parts of the owner's return.
 - (4) Electricity, gas, water, and operating salaries (maintenance, cleaners, gardeners, elevator operators, etc.) to the extent they are not included in construction cost of Form HUD 92330, Mortgagor's Certificate of Actual Cost, or HUD 92330A, Contractor's Certificate of Actual Cost.
 - (5) Management fee stated in the contract.
 - (6) Services not covered by the management fee under paragraphs 3b and c of Handbook 4381.5, Compensations for Management Services in Multifamily Housing Projects with Insured or HUD-Held Mortgages.
- i. Operating expenses may not include:
 - (1) Depreciation
 - (2) Interest, taxes, property insurance premiums, and mortgage insurance premiums, that are reflected in Form HUD 92330, Mortgagor's Certificate of Actual Cost.
 - (3) Salaries paid to principals of the sponsor or mortgagor for managing the mortgagor entity.

- j. Treat net income as:
 - (1) A recovery of construction costs for profit motivated mortgagors.
 - (2) For a nonprofit mortgagor:
 - (a) as a recovery of construction costs at cost certification, to the extent that it was used to reduce liquidated/actual damages,
 - (b) as an offset for an a mortgage increase,
 - (c) deposit the unused portion of net income into the reserve for replacement at final endorsement.
 - k. If operating expenses exceed income:
 - (1) No entry is made on Form HUD 92330, Mortgagor's Certification of Actual Cost.
 - (2) Operating deficit may be carried over as a reduction to net income on the supplemental operating statement.
6. A Certification by an independent Certified Public Accountant or an independent Public Accountant must accompany Form HUD 92330, Mortgagor's Certificate of Actual Cost, including the audited balance sheet and operating statement of the mortgagor, and Form HUD 92330A, Contractor's Certificate of Actual Cost.
- a. The accountant must meet the auditor qualifications of the Government Auditing Standards (GAO Yellow Book), including the qualifications relating to independence and continuing professional education. The audit organization also must meet the quality control standards of the GAO Yellow Book.
 - b. Part 24 of Title 24 of the Code of Federal Regulations prohibits accountants from contracting for services when their name is shown on the HUD and General Services Administration Government-wide Consolidated List of Debarred, Suspended and Ineligible Contractors and Grantees.
 - c. The accountant must also comply with the requirements in Chapters 1,2,3 and 6 of HUD Handbook IG 2000.4, "Consolidated Audit Guide for Audits of HUD Programs."
7. The mortgagor must submit a supplemental operating income statement if more than 3 months exist between the cut-off date and the start of amortization. If a deferment of amortization has been granted, use the new date for the start of amortization in determining the need for a supplemental operating statement.
- a. This requirement does not apply to nonprofit mortgagors, nor any project where the mortgage is \$200,000 or less.
 - b. The statement covers the period from the cost certification cut-off date to the date which is 3 months before the start of amortization and should be submitted within 30 days after the expiration of this period.

- c. The supplemental statement must be prepared and certified by a CPA or IPA if the original cost certification was required to be audited.
 - d. The mortgagor may advance the date of amortization to avoid submitting a supplemental income statement.
 - e. In preparing the statement, if the operating statement submitted at cost certification shows expenses in excess of income, such expenses may be carried forward as "unrecovered expense—prior period."
- C. Section 223(f) Projects. The mortgagor certifies to the total costs incurred in the acquisition or refinancing of the property using Form FHA 2205-A, Mortgagor's Certificate of Actual Cost. The certification must be dated and signed by an authorized agent of the mortgagor. An accountant's opinion is not needed.
1. The certification must be submitted after all critical repairs have been completed, but at least 15 days before the desired closing date.
 2. The general contractor will be required to cost certify using Form HUD 92330A if a cost plus construction contract is used.
 3. A balance sheet and income statement are not required.
 4. No cost certification is required for a 207/223(f) refinancing transaction where the mortgage is equal to or less than 80 percent of value.
 5. For cases involving deferred repairs, the mortgagor must submit a supplemental cost certification detailing the actual cost of the deferred repairs.

14.12

Deficiencies in Cost Certification Submission

When the cost certification package is received for processing:

- A. The Cost and Mortgage Credit reviewers will:
 1. Determine deficiencies associated with the mortgagor's and contractor's cost certifications.
 2. Advise the Hub Director and estimate the time needed to resolve the problem(s).
 3. Attempt to resolve all problems by telephone before making a formal written request. This usually allows processing to continue while waiting for a formal reply.
 4. Send a letter within 5 workdays to the mortgagor with copies to the general contractor (if applicable), their accountants, and the mortgagee stating the deficiencies and requesting information.
- B. Upon receipt of all necessary information, combined processing should not exceed 15 workdays.

- C. If the mortgagor or contractor indicates clarification will be forwarded within a very few days, the conclusions of cost certification can await the additional information.
- D. If not, issue Form 2580.

14.13**HUD Mortgage Credit Limited Review**

- A. In cases where the mortgagor has not requested a mortgage increase, the HUD staff will:
 - 1. Review Form HUD-92330, Mortgagor's Certificate of Actual Cost. Adjust for items paid out of working capital and costs reflected on income statement.
 - 2. Review the reporting of:
 - a. Net income earned before the start of amortization. For new construction projects and unoccupied substantial rehabilitation projects, all income earned from the beginning of marketing and rent-up activities to the cut-off date is to be reported. For substantial rehabilitation projects where occupancy is continuous, all income from the date of initial endorsement or, for insurance upon completion cases, the start of construction to the cut-off date is to be reported. Adjustments should be made for ineligible reported expenses, i.e., depreciation.
 - b. The reporting of all grants/loans received for replacement cost items.
 - 3. Complete Form HUD-92580, Maximum Insurable Mortgage, using the figures from Column C, Total, of Form HUD-92330. Complete the forms using the instructions in the MAP Forms Book, except for the following changes:
 - a. Line 2. Reflect the amount indicated in Column C of Form HUD-92330.
 - b. Line 3. Explain any adjustments made to the net income or grant/loan amounts reported on Form HUD-92330.

NOTE: If adjustments are made to items other than net income and grants/loans, Form HUD-92331A should be completed.
 - 4. Report anything suspicious in the submission, to the Hub Director, who has the authority to request that a full cost certification review be completed. For such cases, Forms HUD-92331-A, and HUD-92580 are to be completed based on the instruction in the MAP Forms Book and this chapter. Also, if an accountant's work is consistently deficient, the accountant should be warned that mortgagors using their services will be advised that a detailed cost certification review will be performed by HUD.

14.14**HUD Mortgage Credit Detailed Review**

When a mortgage increase is requested of the Hub Director, a more detailed review is required. The HUD Mortgage Credit staff will:

- A. Carefully review Forms HUD-92330 and HUD-92330-A if required for mathematical accuracy and compliance with prescribed procedures.
- B. Ensure that the submission contains required schedules and bills, which have not been submitted with previous draw requests, to support the certified amounts for interest, taxes, property insurance, MIP, title and recording, financing fees, legal, organizational and audit fees, offsite costs and other fees.
- C. Require clarification or breakdown of all, or any part of, the cost figures presented by the mortgagor or general contractor, if applicable.
- D. Question the existence of any identity of interest subcontractor, material supplier or equipment lessor.
- E. Review the notes and schedules attached to the accountant's opinion.
- F. Recommend that the Hub Director request an audit of the mortgagor's and/or contractor's books by the Regional Inspector General for Audit before issuing Form HUD-92580, Maximum Insurable Mortgage, when differences of opinion arise from other than:
 1. Genuine misunderstanding of HUD instructions.
 2. Honest differences of opinion clearly identifiable as such.
 3. Other justifiable causes.
- G. If considerable time has passed between initial occupancy and the cut-off date, some items properly allocable to renting and operating the project may be charged against construction cost.
 1. It may not be possible or practical to make precise allocation of such items as gas and electricity, clean-up costs, etc., between construction and operation periods.
 2. Insist on reasonable allocation(s) and eliminate duplicate claims for the expenses under both categories.
- H. Advise Cost staff of any construction costs included in "Miscellaneous" and "Other" categories of Form HUD-92330.
- I. Check items and amounts in the mortgagor's cost certification without auditing the mortgagor's books and records. An audit may be needed later. (Refer to Paragraph 14.27)

- J. Record the results of the review on Form HUD-92331A, Cost Certification Review Worksheet.

14.15**Allowable Costs in Form HUD-92330,
Mortgagor's Certificate of Actual Cost**

A. Construction Contract:

1. A lump sum construction contract is permitted when no identity of interest exists between the mortgagor and general contractor. The amount allowed in cost certification is the lesser of:
 - a. Actual cash paid or to be paid by the mortgagor under the construction contract.
 - b. Contract price as adjusted by HUD's estimated cumulative effect of approved change orders paid, or to be paid, by the mortgagor and the liquidated/actual damages provision to the contract, if applicable.
2. A cost-plus construction contract is required when an identity of interest exists between the mortgagor and general contractor.
3. The amount allowed in cost certification when a cost-plus contract is used is the lesser of:
 - a. Actual cash paid, or to be paid, by the mortgagor under the construction contract.
 - b. Amount the cost analyst allowed for construction on Form HUD-92331, Summary of Cost Certification Review—Cost Section.
 - c. Contract price as adjusted by the HUD estimated cumulative effect of approved change orders paid, or to be paid, by the mortgagor and, if applicable, either the incentive provision or the liquidated/actual damages provision of the contract.

NOTE:

- (1) Recognize approved change orders necessitated by errors or omissions by the architect only to the extent there are savings in the mortgage. Do not recognize these change orders when processing a mortgage increase.
- (2) Do not recognize approved betterment change orders in calculating the adjusted upset price in Paragraphs A.1.B. and A.3.C, unless they are determined by the Cost staff to be necessary changes as defined in Paragraph 13.8.
- (3) Recognize the increase in general requirements, if any, noted on approved time extension change orders. Do not recognize increases in soft costs associated with the change order. The soft costs will be recognized under the applicable line items.
- (4) When BSPRA is not applicable, for profit motivated projects involving an identity of interest between the mortgagor and general contractor, the amount of builder's profit as shown on Form HUD-3305 or 3306 is eligible whether or not it was paid in cash.

- (5) For nonprofit mortgagors, the allowable builder's profit is the lesser of the amount actually paid or to be paid in cash to the general contractor or the amount of builder's profit shown in Section G of Form HUD-92264, plus or minus any amount applicable due to HUD-approved change orders.
4. An identity of interest is construed to exist when:
- a. There is any financial interest of the mortgagor in the general contractor or any financial interest of the general contractor in the mortgagor.
 - b. Any officer, director, or stockholder or partner of the mortgagor is also an officer, director or stockholder or partner of the general contractor.
 - c. Any officer, director, stockholder, or partner of the mortgagor has any financial interest in the general contractor; or any Officer, director, stockholder, or partner of the general contractor has any financial interest in the mortgagor.
 - d. The general contractor advances any funds to the mortgagor.
 - e. The general contractor supplies and pays, on behalf of the mortgagor, the cost of any architectural services or engineering services other than those of a surveyor, general superintendent, or engineer employed by a general contractor in connection with its obligations under the construction contract.
 - f. The general contractor takes stock or any interest in the mortgagor corporation as consideration of payment.
 - g. There exists or comes into being any side deals, agreements, contracts, or undertakings entered into or contemplated, thereby altering, amending, or canceling any of the required closing documents, except as approved by the Secretary.
 - h. Any relationship (e.g. family) existing which would give the mortgagor or general contractor control or influence over the price of the contract or the price paid to the subcontractor, material supplier or lessor of equipment.
5. Incentive. The construction contract may be modified before initial endorsement to provide for a contractor's incentive when construction is completed before the date specified in the construction contract (as amended by HUD-approved time extensions).
- a. Identity of interest mortgagor and general contractor.
 - (1) General contractor may benefit from savings in construction interest, taxes, property insurance, and mortgage insurance premiums to the extent there are construction cost overruns.
 - (2) Incentive payment is included in the adjusted upset price of the construction contract.
 - b. Nonidentity of interest mortgagor and general contractor.
 - (1) Use Construction Contract Incentive Payment, Form HUD-92443.
 - (2) Include the incentive payment under "Other" on Form HUD-92331A.

6. Damages Clause. Apply the damages clause of the construction contract when the general contractor does not complete the project on time. The clause holds the general contractor financially responsible for the added soft costs resulting from the contractor's delay.
 - a. Calculate the amount of actual damages and liquidated damages, using the lesser to determine the adjusted upset price.
 - b. To determine actual damages, compute the actual cost of interest, taxes, insurance, and MIP for the period from the scheduled completion date (as amended by HUD-approved change orders) through the final completion date.
 - c. To determine liquidated damages multiply the daily liquidated damages rate from the construction contract by the number of days between the scheduled completion date specified in the construction contract, as amended by the HUD-approved time extensions, through the final completion date.
 - d. Reduce the damages by the portion of the net operating income earned during the liquidated/actual damage period.
 - e. For those cases where an administrative completion date has been established, use this date for computing damages for cost certification purposes. However, the general contractor is responsible for damages through the date of final completion.
7. If a mortgagor acts as its own general contractor:
 - a. A construction contract is not executed. Instead, Form FHA-2441-Supplement, is added to the Building Loan Agreement, Form HUD-92441.
 - b. The upset price for construction is line 51 of the approved Form HUD-2328, Contractor's and/or Mortgagor's Cost Breakdown (Schedule of Values), as adjusted by the cumulative effect of HUD-approved change orders and the incentive provision, if applicable.
 - c. Incentive clause, if any, is incorporated by addendum to Form FHA-2441-Supplement.
 - d. There is no liquidated/actual damages clause.

NOTE: The mortgagor may serve as its own general contractor only when the mortgagor is an individual or a general partnership.
8. Incomplete Minor Items. The mortgagor's certification of the amount due under the terms of the construction contract may include the cost of minor items of on-site work which remain incomplete under the construction contract.

B. Architect's fee(s) are limited to the amounts paid in cash.

1. Recognize the cost of additional services set form in Article 10 of the Standard Form of Agreement between Owner and Architect for Housing Services, AIA Document B181. Ask Architectural and Cost staff to check the reasonableness of these charges.
2. Disallow:

- a. Any portion of the Architect's fee paid in stock.
 - b. Any costs associated with a clerk of the works.
 3. If any identity of interest comes into being between the Architect and either the mortgagor or general contractor during project construction:
 - a. See maximum design Architect's fee for cost certification purposes set forth in the Agreement and Certification, Form HUD-3305/3306.
 - b. Do not allow a fee for supervisory services to an identity of interest Architect.
 4. Treat any unused balance of the total Architect's fee as a direct mortgage reduction to the original mortgage amount on Form HUD-92580.
- C. Interest is allowable in the amount accrued on the first mortgage between initial endorsement (start of construction for insurance upon completion projects) and the cut-off date defined in Paragraph 14.7.
1. Recognize interest costs associated with an approved early start provided:
 - a. The mortgagor entered into an agreement with the contractor which:
 - (1) was approved by the Hub Director.
 - (2) agrees to reimburse the contractor for interest on money borrowed for construction prior to initial endorsement.
 - (3) states that reimbursement will be made only to the extent the mortgagor has funds available in the amount estimated for interest during construction.
 - b. The certified amount, when added to the interest cost incurred directly by the mortgagor, does not exceed the total amount of interest estimated in Section G of Form HUD-92264.
 - c. Form FHA-2415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, was executed and approved.
 - d. Interest costs reflect the contractor's actual cost of money borrowed to cover the cost of construction between the early start date and the initial endorsement as adjusted by Section 1.e below.
 - e. Rate of interest does not exceed rate established for the insured loan.
 2. Interest rate paid on the construction loan cannot exceed:
 - a. For insurance of advances: the rate stated in the Firm Commitment.
 - b. For insurance upon completion: the rate acknowledged by the Hub Director of Housing Development before issuing the Firm Commitment.
 3. Deduct accrued interest forgiven by the lender or otherwise not paid in cash.

4. Treat lender/bond underwriter's refund of any portion of the construction loan interest to the mortgagor or sponsor, as a direct mortgage reduction to the original mortgage amount on Form HUD-92580.
 5. If the construction interest rate changes before initial endorsement and it was not feasible to reprocess the project or if a State Housing Agency sold bonds to finance the construction loan and the true interest rate was not known until cost certification:
 - a. Interest savings may be created from the difference between the processed interest rate and the actual final interest rate.
 - b. Treat these savings as a direct mortgage reduction if the condition in Paragraph XX was included in the Commitment.
 6. Neither the interest on subordinated liens nor other obligations of the mortgagor are allowed as certifiable costs.
- D. Taxes are allowable in the amount accrued during the same period identified in Paragraph C above. Do not recognize costs accrued during early start period.
- E. Property insurance is allowable in the amount accrued during the same period identified in Paragraph C above. Do not recognize costs accrued during early start period.
- F. Mortgage Insurance Premium (MIP). The FHA Comptroller's office cannot compute the exact amount of MIP due during the construction period until the project has been completed and the Washington Docket forwarded to Headquarters.
1. For a project involving insurance of advances, allow MIP of $\frac{1}{2}$ of one percent per annum on the mortgage amount on the basis of accrual for the number of days in the period used to Paragraph C above, when applicable.
 2. For a project involving insurance upon completion, no MIP is paid during construction.
- G. HUD application, commitment and inspection fees are allowable in the amounts paid. Fees paid to reopen an expired or terminated commitment are not allowable costs.
- H. Financing expense includes the initial service charge, discounts fees, FNMA or GNMA or other permanent lender commitment and marketing fees, and other similar fees.
1. Allow the lesser of:
 - a. Amounts paid, or to be paid, in cash.
 - b. Amounts shown on Form HUD-2434, Mortgagee's Certificate, or Certificate of Mortgagee portion of Form FHA-2455 and approved by the Hub Director before initial endorsement (Insurance of Advances) and issuance of Firm Commitment (insurance upon completion), respectively.

2. Construction Lender's initial service charge (usually 2 percent):
 - a. Is expected to cover:
 - (1) Processing fees.
 - (2) Expenses of lender's counsel.
 - (3) All other charges by the construction lender.
 - b. Excludes:
 - (1) Construction loan discount.
 - (2) Construction loan extension fees.
 - c. 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 initial service charge to exceed 2 percent, are not certifiable. Charges related to "Title and Recording" expenses are certifiable under that line item.
3. Permanent Lender's placement fee (usually 1.5 percent):
 - a. Is expected to cover all permanent placement expenses except discounts and some of the fees associated with a bond financed transaction.
 - b. If GNMA Mortgaged Backed Securities are involved, the mortgagee may not assess an additional charge for the MBS application fee or for the custodial or delivery fee.

NOTE: Construction and Permanent Lenders' fees in the aggregate shall not exceed 3-1/2 percent and may be divided as agreed upon by the parties involved.
4. Recognize for cost certification:
 - a. Reasonable discounts (based upon current interest rate levels at the time of initial closing for projects involving insurance of advances and issuance of the Firm Commitment for projects involving insurance upon completion) charged by the construction and permanent lenders and extension fees charged by the construction lender, if funded at initial endorsement and shown on the Mortgagee's Certificate, Form HUD-2434.
 - b. Permanent lender extension fees, shown on Form HUD-2434, if funded before the final completion date.
 - c. For insurance upon completion cases, construction and permanent loan extension fees, shown on the Certification of Mortgagee portion of Form FHA-2455, if funded before cost certification cut-off.
 - d. Financing fees (including extension fees and discounts) paid on behalf of a mortgagor by a third party under Paragraph 18(f) of the Mortgagee's Certificate or Paragraph 10h of Certificate of Mortgagee portion of Form FHA-2455 and shown as a current liability on the mortgagor's balance sheet to the extent there are savings in the

mortgage. At final endorsement, require a promissory note be used for any unpaid balance of the obligation recognized in cost certification.

- e. For bond financed projects, cost of issuance, discounts and financing fees in excess of 3-1/2 percent provided the cost certification evidences that the sponsor/mortgagor could not benefit monetarily from excess investment income from the proceeds of the invested obligations. Refer to Appendix 14.
5. Do not recognize for cost certification:
 - a. Any “side deals” (except for approved discounts) by which the mortgagor agrees to pay for “added cost of money.”
 - b. The cost of purchasing of FNMA stock.
 6. Treat the following as a direct mortgage reduction at final endorsement:
 - a. Premiums paid by Lender to the mortgagor or sponsor for acquiring the construction or permanent loan.
 - b. Partial refunds of the Commitment fee allowed in processing, which are returned to the mortgagor or sponsor.
 - c. Discounts or other fees paid for by a contribution of a portion of the initial service charge by the Lender/bond underwriter.
 - d. Rebates paid to a mortgagor or sponsor by the Lender/bond underwriter for bond financed mortgages.
- I. Title and recording expense is limited to cash paid for:
 1. Title search and policy at the time of initial endorsement;
 2. Recording fees at initial endorsement;
 3. Mortgage and stamp taxes;
 4. Survey recording fees;
 5. Updating title policy during construction;
 6. Final title policy and recording charges; and
 7. Legal fees incurred with any of the above.
 - J. Legal, organization and audit expenses are limited to expenses incurred in organizing the mortgagor entity, developing the proposal to submit to HUD and other necessary governmental agencies and required services during closing and construction.
 1. Organizational allowance:

- a. Allow only the amount included in Section G of Form HUD-92264 for organizational fee, unless fully supporting documentation is submitted by the mortgagor which justifies the need for and reasonableness of the additional expenditure.
 - b. Any costs incurred in excess of this allowance are not eligible for recognition in processing a mortgage increase or the equity computation on Form HUD-92580.
2. Allow a marketing allowance for Section 232.
 3. Limit legal expenses to those incurred for: initial through final closings; tax advice during organization of mortgagor entity only; and preparation of documents and representation for and during organization of the mortgagor entity.
 - a. Allow customary expenditures expected to be incurred before and during initial closing, construction period, and final closing.
 - b. Do not allow:
 - (1) The usual expenses connected with land acquisition which are already included in, or contributing to:
 - (a) Title and recording expense.
 - (b) Estimated market price of site.
 - (c) Obtaining changes in zoning.
 - (2) Cost of legal services to create tax shelters, trusts, etc.
 4. Recognize cost of a “package deal” for organization and legal services provided:
 - a. Supplier is qualified to furnish the needed services.
 - b. Do not allow duplicate credit for the same services.
 5. Audit fee covers the cost of the accountant’s audit and opinion of the mortgagor’s certificate of costs.
 6. Amounts included in Form HUD-92264 for legal and audit expenses are not blanket allowances, but ordinarily set an upper limit on allowable amounts.
 - a. Non-typical fees must be borne by the mortgagor, unless in an exceptionally complex case, a higher fee is proven by the mortgagor to be necessary and reasonable. Detailed invoices and/or other documentation is required as to the reasonableness, purpose, necessity, and proper classification of all items in the category.
 - b. This limitation is not flexible where a “package” for legal and organizational services is involved or where a substantial amount of the legal and organizational services are performed by the same firm.

- K. Offsite Costs. Where the mortgagor enters into a supplemental contract for constructing offsite improvements, allow the lesser of:
1. Contract price as adjusted by the HUD's estimated cumulative effect of approved offsite change orders.
 2. Actual cash paid or to be paid for offsite work.
 3. Amount allowed by cost analyst for offsite construction of Form HUD-92331, Summary of Cost Certification Review - Cost Section.

NOTE:

- a. The Valuation Branch must adjust the as-is land value of the property, if the allowed amount for offsite and demolition differs from HUD's estimate on Form HUD-92264 issued at Firm Commitment.
 - b. Offsite cost is not allowable for leasehold estates when the ground rent is based on a land value that reflects all required offsite improvements since those improvements have not been paid for by the mortgagor.
 - c. If the mortgagor certifies to off-site cost, the land value entered on Form HUD-92580, "Maximum Insurable Mortgage" will be reduced by the amount of off-site cost.
- L. Other Costs include all costs and/or recovery of costs which are not provided for elsewhere and which are clearly attributable to the actual cost of the project.
1. Cost of acquiring the leasehold interest provided the acquisition cost plus ground rent and offsite costs paid by the mortgagor, if any, do not exceed the HUD Fair Market Value of the Land Fully Improved. Any excess is to be reflected as a disallowed cost of acquiring the leasehold.
 2. Ground rent paid during the period used in Paragraph C above.
 3. Incentive payment due a nonidentity of interest contractor for completing construction before the scheduled completion date as amended by HUD-approved change orders.
 4. Compensation from an insurance claim including any income earned by investing the proceeds of the claim. Treat as recovery of cost after computing BSPRA.
 5. Contractor's bond premium if paid by the mortgagor. If the construction contract contained an amount for the bond premium, subtract it from the contract amount when developing the adjusted upset price on line 1c of Form HUD-92331A.
 6. Other fees, including engineering and topographical survey. Cost staff must determine if such costs are reasonable and not duplicated in the general contractor's costs.
 7. Contingency reserve is included in the replacement cost of substantial rehabilitation projects.

- a. The contingency reserve may be used for unforeseen costs of necessary change orders approved by HUD and unanticipated soft costs for time extensions approved by HUD.
 - b. Expenditures for change orders and shortfalls in soft costs should be certified to and allowed under those specific line items.
 - c. Normally there will not be an amount certified to under contingency reserve since all expenditures will be certified to on other line items.
 - d. An itemization of all expenditures covered by contingency reserve funds must be attached to the cost certification submission.
8. Grants/loans to the mortgagor entity and/or principals of the mortgagor entity used to pay for allowed items of cost.
- a. Treat as a recovery of cost after BSPRA.
 - b. Do not deduct grant/loan funds used to pay for non-replacement cost items, i.e., grant/loan proceeds used to pay the acquisition cost of the land in excess of the HUD allowance are not deducted from the total recognized costs.
9. Residential relocation fund established on Form HUD-92264. Allow only those expenses approved by the HUD CPD relocation specialist up to the amount established on Form HUD-92264. Apply unused allowance as a direct mortgage reduction.
10. Third party costs for appraisals, market analysis, etc., involved with MAP processing.

M. Builder's and Sponsor's Profit and Risk Allowance (BSPRA)

1. HUD does not control the division of BSPRA.
2. Compute without regard to amounts on Form HUD-92264. Base the BSPRA computation on a percentage of allowed costs.
 - a. Use the same percentage (not to exceed 10 percent) used to compute BSPRA in the Firm Commitment review.
 - b. Exclude from the computation the cost of off-site work, land, payments for acquisition of leasehold, ground-rent, relocation expenses, and supplemental management funds, and Major Moveable Equipment, if applicable.
3. 50/75 percent rule.
 - a. Whether or not there is an identity of interest, no general contractor's fee (general overhead and profit) will be allowed when:
 - (1) More than 50 percent of the contract sum in the Construction Contract–Cost Plus, Form HUD-92442-A, is subcontracted to one subcontractor, material supplier or equipment lessor, or

- (2) 75 percent or more with three or less subcontractors, material suppliers and equipment lessors.

Note:

If two or more subcontractors have common ownership, they are considered as one subcontractor.

- b. Exceptions: The fifty/seventy-five percent rule is not applicable to:
 - (1) Manufacturers of Industrialized Housing.
 - (2) Trade items performed by persons on general contractor's payroll.
 - (3) Mobile Home Park program.
 - (4) Supplemental Loan program.
 - (5) Rehabilitation programs other than gut rehabilitation.
 - c. The cost analyst determines the applicability of the 50/75 percent rule.
 - d. Where the 50/75 percent rule is violated, the general contractor forfeits its profit and only Sponsor's Profit Risk Allowance (SPRA) is allowed.
4. Where there is no identity of interest between the mortgagor and builder or when the 50/75 percent rule has been violated, compute a SPRA which is 10 percent of allowable:
 - a. Architectural fees.
 - b. Carrying charges and financing.
 - c. Legal, organization, and audit expenses.
 5. If an identity of interest between the mortgagor and general contractor is established after initial endorsement and exists at the time of final completion, BSPRA is allowed in lieu of a builder's profit and SPRA.
 6. If prior to the final completion date an identity of interest no longer exists between the mortgagor and builder, substitute SPRA for BSPRA.
 - a. The construction contract may be amended to permit a typical builder's profit.
 - b. Treat the difference between BSPRA and the combination of SPRA and builder's profit as a direct mortgage reduction on Form HUD-92580.
- N. Non-profit Developer Fee. The allowable amount is the amount included in the Firm Commitment **less** amounts certified and allowed on other line items.

- A. Actual costs are all costs, paid by the general contractor under the Construction Contract for completion of the project, and to which the general contractor certifies, using Form HUD-92330A.
1. Include actual costs paid in cash, or to be paid in cash (items of delayed completion), within 45 days after the date of the substantial completion, for labor, materials, equipment, subcontract work, general requirements (job overhead), fees and general overhead. Also include amounts estimated for any items requiring an escrow.
 - a. General Requirements:
 - (1) May include salaries of clerical staff for time actually spent at the project site. Proration of annual salaries on the percent basis is not permitted.
 - (2) Salaries of executives may not be included in General Requirements. Such salaries are included in General Overhead.
 - b. General Overhead:
 - (1) Include only the amount of the accepted Schedule of Values, Form HUD-2328, adjusted by the effect of approved change orders.
 - (2) Itemization is not required.
 2. Kickbacks, rebates, adjustments, discounts, or any other devices which the contractor may have received or is entitled to, must be deducted from actual costs.
- B. For those cases where the mortgagor is not seeking a mortgage increase or a detailed review is not requested by the Hub Director:
1. The cost analyst will not review Form HUD-92330A, Contractor's Certificate of Actual Cost, in assisting the Mortgage Credit Examiner (MCE) in the analysis of the Mortgagor's cost certification.
 2. The cost analyst will advise Mortgage Credit Staff of the approved change orders.
- C. Cost Review
1. Conduct a detailed review when the mortgagor applies for a mortgage increase or the Hub Director orders a detailed review.
 2. Review certifications where required from the contractor, or any subcontractor, equipment lessor, material supplier or manufacturer of industrialized housing.
 3. Forms necessary to make reviews:
 - a. Form HUD-92330, Mortgagor's Certificate of Actual Cost.
 - b. Form HUD-92330-A, Contractor's Certificate of Actual Cost.

- c. Forms FHA-3305, or 3306, Agreement and Certification (applicable to project).
 - d. Form HUD-92437, Request for Construction Changes–Project Mortgages (all approved for project).
 - e. Form HUD-92326, Project Cost Estimate (HUD Estimate).
 - f. Form HUD-2328, Contractor’s and/or Mortgagor’s Cost Breakdown.
 - g. Form HUD-92331-B, Cost Certification Review Worksheet.
 - h. Form HUD-92331, Summary of Cost Certification Review.
 - i. Form HUD-95379, Trip Report (all for projects).
4. Steps to make review:
- a. 50/75 percent rule check (See 14.15.M.3): Use information from “total” and “name of subcontractor or payee” columns of general contractor’s cost certification. If rule applies, disallow general contractor’s general overhead and profit. If project uses BSPRA, disallow only general overhead, but inform mortgage credit examiner.
 - b. Identity of interest subcontract review: (Mortgagor, general contractor, subcontractors, equipment lessors, material suppliers, and industrialized housing manufacturers.)
 - (1) Examine Form HUD-3305 or HUD-3306 and Form HUD-92330-A to establish all declared identities of interest.
 - (2) Review each identity of interest subcontractor’s cost certification.

NOTE: If cost certification not received, disallow subcontractor’s overhead, profit, and all questionable costs.

 - (a) If no prior approval as an identity of interest subcontractor, disallow subcontract overhead and profit.
 - (b) For prior approval:
 - (i) Allow prior approved subcontract overhead and profit, plus or minus the effect of approved change orders. Disallow excess.

NOTE: Do not reduce the prior approved subcontract overhead and profit in the event that the certified cost for the work is less than the prior approved maximum subcontract price.
 - (ii) Allow up to the prior approved maximum subcontract amount for work, plus or minus the effect of approved change orders. Disallow excess.
5. Trade line item review:
- a. On Form HUD-92331-B

- (1) Enter all trade line costs from HUD estimate (Form HUD-93236) or Contractor's schedule of values (Form HUD-2328) after adjusting for approved change orders.
 - (2) Enter all trade line costs from general contractor's cost certification (Form HUD-92330-A). Take architect's fees from mortgagor's cost certification (Form HUD-92330).
 - (3) Using dollar and percentage variance columns, compare each trade's actual cost with the estimate. Determine allowable amounts.
- b. Allowable amounts are not limited by the estimates. Analyze differences.
- (1) Allow actual costs paid to complete the work in accordance with the construction contract.
 - (2) Allow actual costs due to unusual circumstances, e.g., subcontractor bankruptcy, code changes, required replacement of completed work, replacements due to natural occurrences (storms, floods, earthquakes, etc.).
- c. Question only amounts substantially in excess.
- (1) Contact general contractor and/or mortgagor requesting explanation or more documentation.
 - (2) Make disallowances if explanation/documentation is not received in a reasonable amount of time.
 - (3) Reallocation of monies from one trade item to another may be made only by the accountant.
 - (4) As a result of discussion, have the accountant amend Form HUD-92330-A and resubmit.
- d. Disallow any amount not justified or supported as being part of the construction contract work.
- e. Disallow costs for duplication of work due to contractor's error or negligence, e.g., improper placement, failure to protect, noncompliance with contract, etc.

D. Summary of Cost Certification Review on Form HUD-92331

1. Enter all recommended disallowances.
2. Enter summary of construction contract costs.
3. Enter contractor's profit from mortgagor's Form HUD-92330. Add profit from all HUD-approved change orders.
4. Enter offsite costs from mortgagor's Form HUD-92330, if applicable.

- a. Review itemized offsite breakdown.
 - b. Disallow any cost duplication on general contractor's Form HUD-92330-A.
5. Property Insurance Schedule, Form HUD-92329. Complete new form using allowed construction costs.

E. Lump Sum Construction Contract Cost Certification

1. Review mortgagor's certification (Form HUD-92330) if requested to do so by Hub Director.
2. Review cost certification of any subcontractor that has identity of interest with the mortgagor.

F. Section 232 Procedures

1. Follow the above instructions for Section 221(d) and 220 with additions and modifications as indicated below.
 - a. Actual costs include Major Movable Equipment.
 - (1) Mortgagor submits a schedule of Major Movable Equipment installed and the actual cost of each item as part of its cost certification.
 - (2) Major Movable Equipment is not a part of the construction contract, and it is not included in the general contractor's cost certification. Do not include this cost in calculating the 50/75 percent rule.
 - b. Kickbacks, rebates, adjustments, discounts, or any other devices must be deducted from actual cost.
 - c. HUD staff should review:
 - (1) Mortgagor's itemized estimate of Major Movable Equipment submitted at Firm Commitment.
 - (2) Mortgagor's schedule of Major Movable Equipment installed and the actual cost of each item.
 - d. HUD staff should compare Firm Commitment estimate with schedule of actual equipment.
 - (1) Determine whether the schedule of actual equipment installed generally agrees with the list submitted at Firm Commitment.
 - (2) Determine whether actual costs generally agree with estimated amounts at Firm Commitment.
 - (3) If there is general agreement in both the amounts and costs of equipment, accept the schedule.

- (4) Note all new items of equipment that appear questionable; also note significant items appearing in the Firm Commitment estimate which do not appear on the schedule of actual equipment (e.g., 120 beds listed in Firm Commitment estimate but no beds appear in schedule of actual equipment). Also note any costs that are unreasonably higher than those estimated at Firm Commitment.
 - (a) Advise Team Leader to contact mortgagor and request explanation or further documentation.
 - (b) Accept if explanation/documentation is adequate.
2. Summary of Cost Certification Review of Form HUD-92231
 - a. Under Recommended Disallowed, describe any disallowed items of Major Movable Equipment and their cost.
 - b. In the Remarks section, enter the total allowed amount for Major Movable Equipment.
3. Property Insurance Schedule:
 - a. Enter Major Movable Equipment as separate category on Form HUD-92329. Use allowed amount.
 - b. Include in total 100 percent insurable value.

14.17**Determine the Mortgagor's Initial Equity Investment–Nonprofit**

The nonprofit mortgagor will be permitted a six percent return on its initial equity as computed on Form HUD-2580, Maximum Insurable Mortgage.

A. It is determined as follows:

1. New Construction: Line 6, Form HUD-92580, minus finally endorsed mortgage determined in line 10 of the form.
2. Rehabilitation–Property Owned: Reduce the sum of line 4, Form HUD-92580, plus HUD's estimate of the "as is value" of the existing land and improvements before rehabilitation, by the finally endorsed mortgage determined in line 10 of the form.
3. Rehabilitation–Property Acquired: Reduce the sum of line 4, Form HUD-92580, plus the lesser of HUD's estimate of the "as-is value" of the existing land and improvements before rehabilitation or the acquisition cost of the property, by the finally endorsed mortgage determined in line 10 of the form.
4. Rehabilitation under Section 220 and 221(d): Use the New Construction formula in Subparagraph a above.

B. The base equity computed in #1 above may be increased by:

1. The cost of furnishing, equipment or other betterments essential to the operation of the project.
 2. The nonprofit developer's fee used to reduce the estimate closing costs of the project.
 3. Grants from national, regional, and local community service organizations (non-government source).
 4. Sponsor's cash contribution for the cost of land over and above what HUD has allowed.
- C. Modify the Regulatory Agreement to require the return on equity be used for:
1. Continued affordable housing initiatives; or
 2. Pledged to the repayment of surplus cash or residual receipts notes given in favor of secondary financing.
- D. Asset Management will monitor the nonprofit mortgagors to be certain that the return on equity is used only for permissible purposes.
- E. The return on equity is paid from surplus cash/residual receipts. Any shortfall in return may be made up from surplus project funds in future years.

14.18**Determine the Mortgagor's Initial Investment**

- A. New construction and substantial rehabilitation projects under Sections 220 and 221(d): Line 6, Form HUD-92580, minus the maximum insurable mortgage determined in line 10 of this form.
- B. Rehabilitation Property Owned under Section 232: Reduce the sum of line 4, Form HUD-92580, plus HUD's estimate of the as is value of the existing land and improvements before rehabilitation, by the maximum insurable mortgage determined in line 10 of this form.
- C. Rehabilitation-Property Acquired under Section 232: Reduce the sum of line 4, Form HUD-92580, plus the lesser of HUD's estimate of the as is value of the existing land and improvements before rehabilitation or the acquisition cost of the property, by the maximum insurable mortgage determined in line 10 of this form.
- D. The amount determined by above Paragraphs 1,2, or 3 may be increased by:
 1. Expended working capital funds not recognized in the cost certification review.
 2. Residential relocation expenses approved by the relocation specialist in excess of the amount established on Form HUD-92264, Section G.

14.19**Lease Payment/Net Income During Construction Period – Section 232**

Lease Payment/Net Income during Construction Period–Section 232

- A. When an identity-of-interest situation exists, all project income in the construction period, irrespective of the lease amount paid by the identity-of-interest lessee, will be considered and mortgage reductions applied accordingly. There should be no difference in the overall basic income figures whether or not there is an identity of interest lessee.
- B. At the time of cost certification, an audited operating statement covering the period from the beginning of marketing and rent-up activities (or date of initial endorsement in rehabilitation projects involving insurance of advances or start of construction for rehabilitation projects involving insurance upon completion) to the cost certification cut-off date, must be submitted by:
1. The mortgagor entity, in all cases;
 2. The lessee, when an identity-of-interest exists between the mortgagor and lessee and the lessee has executed the Regulatory Agreement–Nursing Home, Form HUD-92466 NHL.
 3. The mortgagor entity only, where no identity-of-interest exists between the mortgagor and lessee and the lessee has executed the Regulatory Agreement, Nursing Home, Form HUD-92466 NHL. The mortgagor’s income statement should reflect a market comparable lease payment as income.
 4. The mortgagor, where the mortgagor and the administrator are the same entity and Form HUD-92466 NHL has not been executed.
- C. Treat net income resulting from review of the operating statement as a recovery of construction costs (on Form HUD-92331A, Cost Certification Review Worksheet) for a profit motivated mortgagor and for a nonprofit mortgagor as:
1. At cost certification, as a recovery of construction costs to the extent it was used to reduce liquidated/actual damages.
 2. As an offset for any eligible mortgage increase.
 3. At final endorsement, deposit the unused portion of net income to the Reserve Fund for Replacements.
- D. Nonprofit Developer’s Fee may be used to recover the cost of Administrator’s Salary during lease-up. Check to make sure this cost is not duplicated in the income and expense statement.

14.20**Modified Form of Cost Certification – Section 223(f)**

- A. A modified form of cost certification shall be completed and submitted for review 15 days prior to the initial/final endorsement of the loan for insurance for all projects processed pursuant to Section 223(f) except those 207/223(f) refinancing transactions where 80% of value is the controlling criterion. (In such cases, cost certification is not required.)
1. The mortgagor must certify to the total actual costs incurred in the acquisition or refinancing of the property. The certification must be submitted on Form FHA-2205-A, and it must be dated and signed by an authorized agent of the mortgagor.
 2. The mortgagee must submit the certification to HUD for computation of the maximum insurable mortgage and completion of Section II of Form FHA-2205-A.
 3. If, in a purchase transaction, the amount of the acquisition cost determined allowable at cost certification exceeds the estimate of value which was determined during processing, the rent formula shall be recomputed. This re-computation may be accomplished using the allowable acquisition cost as determined by cost certification and the collar amount of secondary financing represented by the approved promissory notes (Form HUD-92223).
- B. A supplemental cost certification must be submitted by the mortgagor where an escrow was established at endorsement for completion of non-critical repairs. In cases where actual costs are less than estimated, the maximum insurable mortgage must be recalculated. If the maximum insurable mortgage is reduced due to lower actual costs, the mortgagor must either:
1. Provide the required prepayment to the mortgagee.
 2. Have the required prepayment deducted from the repair escrow.

14.21**Mortgage Reduction after Cost Certification**

- A. The National Housing Act requires that the mortgage will not exceed the applicable percentage of actual costs. If certified actual costs are lower than original projected cost as reflected in Form HUD-92264, a reduction in mortgage may be applicable. The Agreement and Certification, Form HUD-3305/3306, also addresses this issue and provides that where the Commissioner accepts, for cost certification, estimates of cost for any item, the later substitution of certified actual costs may require a reduction of the mortgage.
- B. Reductions of cost may arise from:
1. Refunds, rebates, or discounts.

2. Excess of escrows over the actual costs of incomplete construction items.
 3. Refunds of deposits made by the mortgagor to prevent losses to the mortgagee from loss in connection with sale of the mortgage.
 4. Settlement of claims against bonding companies or others after project completion.
- C. At final endorsement, the mortgagor must set up a cash escrow to pay all "to be paid in cash items" identified on Form HUD-92330, Mortgagor's Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid on Form HUD-92330.
1. Reconcile the difference between:
 - a. Obligations listed on Form HUD-92023, Request for Final Endorsement of Credit Instrument or FHA-2455 (For Insurance Upon Completion Projects only).
 - b. The "to be paid" column on Form HUD-92330 plus debts to third parties.
 2. Difference must be supported by paid receipts and a statement from the mortgagor identifying by name and cost, those items paid in cash. The receipts and statement are affixed to Form HUD-92023/FHA-2455.
 3. Do not accept personal or business checks issued by the mortgagor at final endorsement as evidence of payment. Payment must be in certified or cashier checks.
 4. Prepare a new Form HUD-92331A to disallow obligations listed as "paid" or "to be paid" on Form HUD-92330, which are represented at final endorsement as paid by HUD-approved notes. Prepare a new Form HUD-92580 from the total of HUD-approved cost of revised Form HUD-92331A.
 5. Undisbursed mortgage proceeds may supplement or satisfy the cash escrow.
 6. Use Form HUD-92476-1, Escrow Agreement for Unpaid Construction Costs:
 - a. To set up the cash escrow.
 - b. Attach a detailed listing of the unpaid costs.
 7. Use Form HUD-92464, Request for Approval of Advances of Escrow Funds to disburse escrow.
 8. Escrow should be disbursed within 45 days after final endorsement. If all of the funds are not disbursed follow the procedures in D below.
 9. At final endorsement, if all obligations have been paid in cash, nothing else is needed.
- D. Sixty days after final endorsement:
1. Prepare a new Form HUD-92331A. Enter under the column heading:
 - a. "2264" - the amount of each item of cost recognized from the earlier Form HUD-92331A "Allowed" column.
 - b. "2330/2330A" - the amount listed in Column C of the Mortgagor's Certificate of Actual Cost, Form HUD-92330, for each item of cost.

- c. "Allowed" - the amounts paid in cash based on the reconciliation performed in Paragraph B above and disbursements from the cash escrow account.
 - c. "Disallowed" - the lower of the amounts previously allowed or paid in cash.
 2. Compute a new Maximum Insurable Mortgage, Form HUD-92580, based on the total of the "Disallowed Column" (Form HUD-92331A). If this computation produces an amount less than the mortgage finally endorsed:
 - a. Notify the Directors of Housing Development and Management by memorandum that prepayment to the mortgage is required.
 - b. Prepayment is mandatory and is applied:
 - (1) In amounts equal to the scheduled monthly principal payments, to the extent possible.
 - (2) Any remainder goes to the Reserve for Replacements Fund.
 - c. If HUD is notified that payment has been delayed because of a dispute or litigation, retain funds to pay the amount pending resolution of the dispute.
 - d. Notify the mortgagee or escrow agent by letter of the required prepayment.
 - e. Control the remaining balance in a special account, as a reserve for unpaid construction costs from which disbursements may be made only after written consent of the Field Office.
 3. The mortgagee will continue to use the existing amortization schedule for servicing the mortgage.
 - a. The prepayment is in addition to the regular monthly payments to principal.
 - b. There is no adjustment in the amount of the annual MIP due because of these mandatory prepayments.
 4. The escrow requirement does not apply to funds the general contractor owes. However, the general contractor must submit a reconciliation of its "to be paid" items.

14.22**Increase in Mortgage Amount**

- A. Timing—Generally, requests for a mortgage increase should not be considered until the project is complete, cost certification has been submitted, and final endorsement will likely be achieved immediately following processing of the mortgage increase.
- B. Base for considering mortgage increase:

1. Necessary changes that arise from differing site conditions (as defined in the construction contract).
 2. Compliance with local codes.
 3. Unforeseen conditions that may affect the safety and health of occupants.
 3. Betterments that are economically justified (e.g., those that produce significant cost savings to project operation, can be reflected in increased income expectancy, or enhance the security of the mortgage).
- C. Costs caused by extensions in construction time, when such extensions: are approved by HUD; justifiable under AIA General Conditions; and caused by problems beyond the contractor's control.
- D. Other costs not known at Firm Commitment resulting from requirements of local authorities and beyond the mortgagor's control.
- E. Construction (hard) cost increases caused by a natural disaster declared by Federal or State government, to the extent not covered by casualty insurance.
- F. Increased costs resulting from concealed subsurface site conditions, provided it is determined that exploratory tests during project design were sufficient and thorough and neither the architect nor engineer were at fault.
- G. Cost of substituting a general contractor when the original general contractor is terminated for cause and the surety has failed to perform.
- H. To correct a substantial HUD error in the original processing which would otherwise result in serious inequities.
- I. Any mortgage increase for an insured project must be more than 2-1/2 percent of the original mortgage and at least \$50,000.

14.23**Restrictions for Mortgage Increases**

- A. A mortgage increase may not be granted for cost overruns associated with: completion of the work in accordance with the original contract documents by the original contractor, changes made primarily for the convenience of the mortgagor or contractor, nor for the aggrandizement of the mortgagor or contractor.
- B. Cost overruns are not a basis for granting a mortgagor's request for mortgage increase nor are changes made primarily for the convenience or aggrandizement of the mortgagor or contractor.

- C. Any mortgage increase for an insured project must be more than 2-1/2 percent of the original mortgage and at least \$50,000.
- D. The increase must be supported by net income under Criterion 5 of Form HUD-92264-A.
- E. A mortgage increase may not be granted for replacing a contractor where the mortgagor sets up a “straw contractor” for purposes of BSPRA.

14.24**Processing a Mortgage Increase**

Technical processing consists of Step One through Step Four below. The four steps to processing a mortgage increase, depending on the condition being considered, are:

- A. Step One: Use the alternative applicable to the condition being considered:
 - 1. Alternative One. Applicable to necessary and betterment change order cost increases.
 - a. Architecture and Valuation staff review the change orders to determine eligibility for processing a mortgage increase. Architecture further reviews for the added cost.
 - b. Mortgage Credit computes the allowable costs on Form HUD-92331-A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.d. Reduce this amount by the cost attributable to any change order(s) not qualifying for a mortgage increase.
 - c. The adjusted hard cost forms the basis of the mortgage increase computation
 - 2. Alternative Two. Applicable contract time extension increase to soft costs.
 - a. Mortgage Credit computes the allowable costs on Form HUD-92331A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 3 through 6.
 - b. The adjusted soft cost forms the basis of the mortgage increase computation.
 - 3. Alternative Three. Applicable to construction contract cost increases due to a change in the contractor.
 - a. A&E staff computes a new Form HUD-2328 and Form HUD-92264, Section G through Line 50.
 - b. Mortgage Credit staff computes the allowable costs of Form HUD-92331A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.c. for hard cost increases between the original contractor and the contractor completing the work, and Lines 3 through 6 for soft cost increases associated with the change in contractor.
 - c. The adjusted hard and soft costs form the basis of the mortgage increase computation.
 - 4. Alternative Four. Applicable to substantial error in HUD cost processing.
 - a. A and E staff computes a new Form HUD-2328, and Form HUD-92264, Section G through line 50.

- b. Mortgage Credit computes the allowable costs on Form HUD-92231A, Cost Certification Review Worksheet–Mortgage Credit Staff, Line 1.c, using the criteria in below paragraph.
 - c. The allowable construction costs for processing the increase will be based upon the lesser of:
 - (1) The amount of the construction cost certified by the mortgagor, or
 - (2) The upset price of the construction contract as adjusted by approved change orders eligible for a mortgage increase, plus the increases resulting from correcting or errors in the original processing.
 - d. The adjusted hard cost forms the basis of the mortgage increase computation.

NOTE: The mortgage credit examiner must not use the adjusted upset price of the construction contract as a limiting criterion at cost certification where there is a substantial error in HUD cost processing.
- B. Step Two: Mortgage Credit must compute (for use by Valuation in completing Form HUD-92264) the eligible costs and fees for the following: architect’s fees, bond premium if paid by the mortgagor, other fees not included in the construction contract and paid by the mortgagor, interest, taxes, insurance, developer’s fee (if applicable), legal, organizational and audit fees, marketing (if applicable), offsite costs, as-is land value and “as-is” value of property (if applicable). Mortgage credit must comply with the following in computing the costs and fees.
1. Do not increase BSPRA or restore Contingency Reserve or Developers Fee.
 2. Do not include non-mortgageable items (construction or permanent loan extension fees; discount rate, maintenance fees, etc.)
 3. Offset non-mortgageable items by net income (net non-proprietary income, if applicable) to offset amount of mortgage increase, and
 4. For increases caused by natural disaster:
 - a. Consider in the revised cost any increases from any interim closing for: carrying charges, financing fees, and legal fees. Do not include any cost due to construction delays before the disaster,
 - b. Cut the new estimated replacement cost by the amount of any actual recovery through insurance proceeds, and
 - c. Require prepayments to be made for any late recovery of insurance proceeds.
- C. Step Three. Valuation must use the costs and fees developed by Mortgage Credit in Step Two in revising Form HUD-92264. Valuation must consider each of the following:
1. Examination fee, initial service fee, GNMA/FNMA fee, inspection fee MIP, and title and recording based on the approvable increased mortgage amount.

2. Net income derived from market rent, expense and occupancy estimates current as of the date of mortgage increase processing.

D. Step Four. Mortgage Credit must prepare a revised Form HUD-92264-A, using the revised Form HUD-92264 and Trial Form HUD-92264A prepared by Valuation in Step Three.

14.25**Authorization to Reopen Mortgage Transaction**

- A. Advise the mortgagee of HUD's approval or denial of the request for a mortgage increase upon completion of technical processing. Use Specimen Letter–Agreement Authorizing Reopening of Mortgage Transaction, to notify the mortgagee, where a determination is made to increase the mortgage.
 1. Approval of a mortgage increase is subject to the payment of the following fees based on the amount of the increase.
 - a. Application Fee of \$3.00 per thousand of the increase.
 - b. Inspection Fee of \$5.00 per thousand of the increase applicable only where the increase involves construction (hard) costs.

14.26**Document Distribution**

- A. Form HUD-92580, Maximum Insurable Mortgage.
 1. Mortgagee—original and one executed copy.
 2. One executed copy to each of the following: Closing Attorney, Mortgage Credit Control File, Washington Docket, Field Office Docket, Field Office Valuation Data Bank.
- B. Cost Certification Documents. Original documents filed in the Washington Docket and one copy in the Field Office Docket.

14.27**Audit by Inspector General**

The Hub Director should request the District Inspector General for Audit to audit the mortgagor's and/or contractor/s books where apparent discrepancies appear to arise from other than inadvertent error, or creditable misinterpretation of applicable criteria. Do not issue Form HUD-92580, Maximum Insurable Mortgage, before completion of an IG Audit initiated before its issuance. An audit must also be requested for any indicated fraud or material misrepresentation detected after issuance of Form HUD-92580.

14.28**Cost Certification Incontestability**

After HUD approves the certifications, and issues Form HUD-92580, Maximum Insurable Mortgage, they are final and incontestable unless there is fraud or material misrepresentation by the mortgagor, general contractor, or subcontractors.

14.29**Post Closing Escrows**

Post Closing Escrows must be set up at final closing to pay all “to be paid in cash” items identified on Form HUD-92330, Mortgagor’s Certificate of Actual Cost, and debts to third parties who made the original disbursement for an item listed as paid on Form HUD-92330. These amounts may be adjusted for payments made between the cut-off date and the date of final closing.