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## **DRAFT MAP GUIDE Chapter 5 Architectural and Construction Analysis**

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### **CHAPTER 5 ARCHITECTURAL & CONSTRUCTION ANALYSIS**

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## 5.1 Eligible Construction Activities

Construction activities eligible for the FHA insured mortgage programs include new construction, substantial rehabilitation, alteration, and repairs.

The construction activity with the largest scope of work is new construction, which is erecting new buildings with all the necessary site work. Substantial rehabilitation of an existing property involves significant work and describes construction activities that exceed the Aggregate Cost limit defined in this Chapter. Work on existing structures that is less than substantial rehabilitation is categorized as repairs and alterations partly as defined by the International Existing Buildings Code (IEBC 2015, Chapter 2 Definitions and Chapter 5 Classification of Work).

The MAP Guide categorizes construction activities in terms of the costs and the Class of Work for two purposes. The first purpose is to determine eligible construction activities under each program, i.e., by the Section of the National Housing Act. The second is to identify what methods and professional services are appropriate for the design, documentation, supervision, administration, and inspection of the proposed work.

### A. New Construction.

New construction involves building entirely new structures with necessary site preparation. Eligible work activities include constructing detached, semidetached, row, walkup, or elevator-type residential multifamily buildings and accessory structures on the property's improved site as well as any necessary offsite work.

### B. Substantial Rehabilitation.

Substantial rehabilitation is work on existing buildings(s) including any additions for which the Aggregate Cost of construction (the Aggregate Cost) exceeds the Aggregate Cost Limit amount defined as follows:

1. Aggregate Cost means the total costs of all the proposed construction work at the property, including General Contractor fees and Project Architect fees. The Aggregate Cost will also include the amounts spent from the contingency reserve and assurance of completion escrows<sup>1</sup> at the end of construction, as well as any cost increases through change orders.
  - a. For LIHTC transactions, 100% of the contingency and assurance of completion amounts should be assumed to be expended and included in the upfront estimate of the Aggregate Cost.<sup>2</sup>
  - b. The final Aggregate Cost at the completion of all construction, which must include all actual amounts spent from the contingency reserve and assurance of completion escrows as well as any cost increases incurred from change orders, must not exceed

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<sup>1</sup> Construction contingency reserve escrow and assurance of completion escrow, as required per Chapter 8.

<sup>2</sup> See Chapter 5.6.B.6 and its related Footnote for further explanation.

the Aggregate Cost Limit<sup>3</sup> for any applications for refinance or acquisition programs (i.e. Section 223(a)(7) and Section 223(f)).

2. Aggregate Cost Limit is calculated in dollars as follows:

Aggregate Cost Limit = [Base per Dwelling Unit Limit] X [High Cost Percentage multiplier] X [Number of Dwelling Units]

- a. Base per Dwelling Unit Limit. HUD set the Base per Dwelling Unit Limit (Base Limit) at \$15,000 per unit in 2016 and has annually adjusted it for inflation based on the percentage change published by the Bureau of Labor Statistics of the Department of labor or other inflation cost index.
- b. High Cost Percentage. HUD annually calculates and publishes the High Cost Percentage (HCP) multipliers for designated cities based on the industry-standard construction cost index. These published HCP multipliers are used to calculate the threshold for substantial rehabilitation specific to the project's location.
- c. Number of Dwelling Units. The total number of dwelling units should be the count of units at the property upon completion of all proposed construction work, given that the work may include addition and/or deletion of units at the property. The number should include non-rental units and commercial spaces in live/work type units.
- d. High Cost Areas multiplier. The higher limit HCP multiplier for the identified High Cost Areas (315%) is used only to determine the maximum mortgage amount as an exception granted by HUD. This higher limit multiplier for High Cost Areas may not be used in the calculation to define the substantial rehabilitation threshold as described above. ~~The only exception may be for broadly affordable properties and green and energy efficient housing (i.e., properties that qualified for Green MIP rate) where the use of higher multiplier may be allowed on a case-by-case basis.~~
- e. The revised Base Limits and HCPs are both published in Housing Notices titled "Annual Revisions to Base City High Cost Percentage, High Cost Area and Per Unit Substantial Rehabilitation Threshold" for the year and can be located on HUD Website: [https://www.hud.gov/program\\_offices/administration/hudclips/notices/hsg](https://www.hud.gov/program_offices/administration/hudclips/notices/hsg)

### C. Class of Work.

Class of work defines and categorizes construction work on existing properties that is less than substantial rehabilitation. HUD has quoted language from the International Existing Building Code (IEBC) to define classes of work in the context only of this MAP Guide for the purpose of matching appropriate construction documentation and oversight to differing levels of work.<sup>4</sup>

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<sup>3</sup> Given that the actual expenses spent from any contingency escrow or assurance of completion escrow will not be known until the end of construction, whether the level of work and the cost contemplated for the property are appropriate for 221(d)(4) Sub-rehab or 223(f) should be determined conservatively and not aggressively close to the cost threshold limit. The lenders should take caution that at termination of the Repair Escrow when all the additional costs incurred during construction including change orders result in the final Aggregate Cost exceeding the Aggregate Cost Limit, the lender will be subject to enforcement action by HUD.

<sup>4</sup> The IEBC is cited only as a quoted source acknowledging copyright and for no other purpose.

The levels of work defined from the least to most significant in scope and complexity are as follows:

1. Repairs:

- a. Repair means *“the reconstruction or renewal of any part of an existing building for the purpose of its maintenance or to correct damage.”* [IEBC, Section 202 General Definitions] Repairs to site features (not buildings but otherwise similarly defined) are included in this class of work.
  - b. *“Repairs,...include the patching or restoration or replacement of damaged materials, elements, equipment or fixtures for the purpose of maintaining such existing components in good or sound condition with respect to existing loads or performance requirements.”* [IEBC, Section 502.1]
  - c. Repairs also include related work, which is defined as *“work on non-damaged components...necessary for the required repair of damaged components.”* [IEBC Section 502.3]
  - d. In addition, installation of items not previously present in a building or on a site but necessary to address safety, security, accessibility or communications needs are considered “Repairs” when such installation and related work do not require alterations. Examples of such installation include but are not limited to 1) smoke detectors added to bedrooms; 2) signage or pavement markings added to identify accessible paths; 3) panic bars added to exit doors, etc.
2. Level 1 Alterations: *“...include the removal and replacement or the covering of existing materials, elements, equipment, or fixtures using new materials, elements, equipment, or fixtures that serve the same purpose.”* [IEBC Section 503.1]. Examples include removing and replacing an existing flooring or wall finish, etc.
3. Level 2 Alterations: *“...include the reconfiguration of space, the addition or elimination of any [exterior] door or window, the reconfiguration or extension of any system, or the installation of any additional equipment.”* [IEBC Section 504.1]

Examples include 1) adding or demolishing interior walls (partition or loadbearing) to reconfigure dwelling unit layout; 2) adding another bathroom inside a unit; 3) relocating the kitchen within a unit; 4) adding a new air conditioning system that was not previously present to the existing buildings and/or units; 5) adding an elevator to the building, etc.

4. Level 3 Alterations: *“...apply where the work area consisting of all reconfigured spaces exceeds 50% of the building area.”* [IEBC Section 505.1]

**D. Applying Definitions of Construction Activities to Projects.**

“New construction” and “substantial rehabilitation” describe the scope of work proposed for an entire property and invoke requirements that apply to the whole loan transaction.

For work less than substantial rehabilitation, the scope of work must be itemized as individual work tasks and each described and labeled with a Class of Work. For example, in a single

building, there may be some work items identified as “Repairs” and others that are “Level 2 Alterations.” In other cases, a property with multiple buildings may need “Level 1 Alterations” in some buildings while other buildings need “Level 3 Alterations.” The total scope of work in such properties is composed of many work items, each labeled with the appropriate Class of Work.

Therefore, a Class of Work (i.e., Repair, Level 1, 2 or 3 Alterations) describes an individual work item or a group of closely related work items. Class of Work is not applied to the property as a whole or used to label an entire loan transaction. The following steps are required for properly labeling work items with Class of Work:

1. Describe the proposed work as distinct, separate work items, where each item describes a set of construction activities that are similar or related in character and scope.
  - a. For example, the construction activities of removing aged windows, installing new flashing, inserting new window units, patching up siding and repainting, may all be described as “replacement of existing windows” as a single work item.
  - b. An individual work item should not be too broad or include multiple Classes of Work, such as using “kitchen remodeling” to describe replacing the cabinets (Level 1 Alteration) as well as reconfiguring the space by removing existing walls and extending the countertop space to increase the kitchen area (Level 2 Alterations).
  - c. An individual work item must be distinct and described in sufficient detail for accurate estimation and inspection during construction.
2. Each work item listed in Critical or Non-Critical Repairs (per Appendix 5G Section II) describes an individual task (commonly referred to as a “repair item”) and should be labeled with the applicable Class of Work, i.e., as a Repair, Level 1, 2, or 3 Alteration.
  - a. For example, “replacement of existing windows” with windows of the same size in the existing openings should be classified as Level 1 Alteration.
  - b. In the case of “kitchen remodeling” example cited above, such work should be described in two separate work items, such as: 1) “relocate partition walls to modify existing kitchen layout” as one work item labeled Level 2 Alteration; and, 2) “replace existing kitchen cabinets” as a separate Level 1 Alteration.
3. Professional services and documentation required are to be based on the Class of Work of individual work items.
4. The lender will review and confirm for HUD the Class of Work for each work item recommended by the Needs Assessor.

#### **E. Eligible Construction Activities by Program.**

1. Sections 220, 221, and 231: New construction and substantial rehabilitation are permitted. Class of Work does not apply to these programs.

2. Section 241(a): New Construction, Substantial Rehabilitation, Repairs, and all Levels of Alteration activities are permitted.
3. Section 223(f): Repairs and Level 1, Level 2 and Level 3 Alterations are permitted provided that the Aggregate Cost of all such repairs and alterations does not exceed the Aggregate Cost Limit for substantial rehabilitation described in Chapter 5.1.B.1.
  - a. The lender must ensure that the cost of repairs and alterations in refinance or acquisition transactions does not exceed the program eligibility limit notwithstanding any unforeseen circumstance, change in cost, or estimating error.
  - b. Additions (defined here as any expansion of a building footprint with conditioned space) are not permitted to dwelling spaces and residential buildings. Adding a patio or a balcony is considered a Level 2 Alteration given that they are not conditioned spaces.
  - c. Additions to accessory buildings or additions of minor accessory structures (e.g., carports, storage sheds, swimming pools) may be deemed Level 2 or 3 Alterations, subject to the approval of the Director of the Regional Center/Satellite Office.
  - d. Construction of a new accessory building (e.g., community building, gym) is permitted as a Level 3 Alteration. New accessory buildings may not exceed a gross floor area of 5,000 square feet.
4. Section 223(a)(7): The intent of the 223(a)(7) program is to provide a simple, quick refinance option for existing insured properties to improve cash flow by lowering the interest rate or extending the amortization period, reducing the risk of default and improving overall financial performance. Therefore, all proposed work for 223(a)(7) must be limited to the following:
  - a. Construction activities must not exceed the definition of “routine maintenance” per CPD Notice 2016-02;
  - b. Activities must not exceed Class of Work level of Repairs;
  - c. The total cost of repairs and routine maintenance must not exceed \$1,500 per unit, excluding the cost to remedy accessibility deficiencies;
  - d. Any accessibility related repairs must not exceed Class of Work level of Repairs.
  - e. See Chapter 9.1.C.1 for environmental review requirements.

## **5.2 Consultant Qualifications and Responsibilities for Due Diligence**

The lender and the borrower are required to retain competent third party consultants with skills, training and experience appropriate to the scale and scope of the physical characteristics of the property; the nature of architectural and engineering documents required; the kinds of construction

solutions existing or proposed and the due diligence typical of multifamily real estate transactions. In this context, the term “due diligence” is used as a general term for the range of professional examinations, studies, inquiries, research, investigations, reporting, and documentation needed to determine the physical condition, utility and suitability of sites and buildings existing or proposed for multifamily properties.

#### **A. General**

HUD requires both the lender and the borrower to retain professional consultants with qualifications appropriate for the due diligence required for each loan application. In general, these due diligence requirements are:

1. The preparation of a Capital Needs Assessment (CNA) by a Needs Assessor;
2. The preparation of construction documents (plans and specifications) by a Project Architect for new construction, substantial rehabilitation, and significant alterations at existing properties;
3. The review of construction documents and cost estimates for compliance and acceptability by a Construction Analyst;
4. For certain utility conservation incentive programs, the evaluation of utility consumption and energy conservation measures (ECMs) by an energy professional (see MAP Guide Chapter 6.4);
5. Occasional specialized reports as needed (e.g., structural engineers for seismic analysis); and,
6. The preparation of HEROS Environmental Report and the Phase I Environmental Site Assessment (and Phase II Environmental Site Assessments if needed) required by HUD (see MAP Guide Chapter 9.2.C for qualifications of environmental professionals).

#### **B. Scope of Work, Duties, and Qualifications for Lender’s Consultants.**

1. Needs Assessors.

- a. Qualifications.

The lender must select a Needs Assessor with education, professional credentials and field experience appropriate to the assessment assignment considering the age, size, type of building systems, construction methods, and location of the property. The Needs Assessor must be knowledgeable and experienced with local building standards and construction methods, relevant national and international building codes and standards (e.g., International Existing Building Code, International Energy Conservation Code) and specific statutory and regulatory requirements for multifamily housing (e.g., Federal Fair Housing Act Accessibility Guidelines, Uniform Federal Accessibility Standards and the 2010 ADA Standards). In no

event should the qualifications of the Needs Assessor, and any related consultants employed to prepare the CNA, be less than as described in ASTM E2018-15 Standard Guide for Property Condition Assessments: Baseline Property Condition Assessment Process. The Needs Assessor (and any other consultants, specialists or trades contractors engaged for purposes of the needs assessment) may not have any identity-of-interest with the lender or the borrower or its principals, and may not have any personal or business relationship with the borrower (or its principals) that would create a conflict of interest.

- b. Scope of Work, Duties, and Responsibilities.
  - i. The Needs Assessor prepares the CNA for existing improvements in refinance and acquisition transactions. The Needs Assessor identifies and describes all deficiencies and proposed improvements at the property. All CNAs must be reported using the method prescribed by HUD, which is the CNA eTool.
  - ii. CNAs must be prepared by an independent third party hired and paid by the lender<sup>5</sup>.
  - iii. For existing properties except for substantial rehabilitation, the Needs Assessor must conduct on-site physical inspections, including a representative sampling of units, and prepare the CNA in compliance with the instructions at Appendix 5G.
  - iv. The Needs Assessor may prepare dimensioned sketches or diagrams when needed to illustrate particular repairs and alterations. However, drawings required to describe dimensioned remedies for accessibility deficiencies must be done by a registered architect who may be an employee of, or consultant to, the Needs Assessor's firm.
  - v. When a Project Architect and/or a General Contractor are engaged, the Needs Assessor needs to engage with these professionals to accurately reflect the scope of work and costs in the CNA eTool (see Chapter 5.3.C.4).
  - vi. If the proposed application is for a green MIP rate or proposes adjustments to underwritten operating expenses resulting from reduced utility consumption, the Needs Assessor must report utility costs rates, estimated utility use of components, and sustainable utility-conserving future replacement alternatives for the project in the CNA eTool consistent with Chapter 6.

## 2. Construction Analysts.

### a. Qualifications.

The lender must hire a qualified Construction Analyst with experience in multifamily construction to review the drawings and specifications prepared by the

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<sup>5</sup> The owner may hire and pay the third party when CNAs are required for Asset Management oversight of properties with no insured mortgage, such as budget-based rent increase events where no servicing lender is involved.

Project Architect and any related contracts for design and construction services. The analyst must be knowledgeable and experienced with local building standards and construction methods, relevant national and international building codes and standards (e.g., International Existing Building Code, International Energy Conservation Code) and specific statutory and regulatory requirements for multifamily housing (e.g., Federal Fair Housing Act Accessibility Guidelines, Uniform Federal Accessibility Standards, and the 2010 ADA Standards for Accessible Design). In all cases, the lender must ensure that the work experience of the Construction Analyst is consistent with the scale, scope, materials, methods, and technologies existing or proposed at the property.

The lender's Construction Analyst may be a licensed or registered architect or professional engineer but must, at a minimum, have a degree (BS or BA) in architecture, civil or structural engineering or construction with five years of experience in design, construction, or development of multifamily buildings. Alternatively, any person who is a construction contract administrator with a current certification (CCCA) by the Construction Specifications Institute (CSI) and who has administered construction of not less than three multifamily properties with an aggregate construction cost not less than \$30 million may serve as a Construction Analyst.

b. Scope of Work, Duties, and Responsibilities.

The Construction Analyst must:

- i. Visit the site and its environs investing time and attention sufficient to support a knowledgeable and professional review of the due diligence requirements and products as well as the design, specification and construction documents prepared;
- ii. Evaluate the design of proposed and/or existing buildings and the construction materials, methods or technologies employed in the buildings;
- iii. Review the agreements and contracts between the borrower, design professionals, and contractors to ensure that the proposed services are sufficient and clearly defined and that the borrower's right and power to assign the agreement(s) to or for the benefit of the lender is not impaired.
- iv. Evaluate the professional qualifications and experience of the borrower's design and construction team members and any due diligence professionals or contractors retained by the borrower to ensure conformance to HUD requirements and relevance of qualifications and experience to the anticipated scope of work;
- v. Determine that the borrower's and Project Architect's due diligence concerning physical attributes of the site or existing buildings is sufficient to expose and quantify such costs and risks as reasonably may be expected based on observed conditions and identify any unmet due diligence needs;
- vi. Evaluate architectural design, specification, construction contract, and cost and scheduling documents for proposed projects and ensure internal

- consistency, accuracy, reasonableness, and conformance to HUD requirements, including specifically: the Minimum Property Standards; local codes and the HUD minimum energy conservation code when this code exceeds local codes; accessibility requirements for persons with disabilities (see Appendix 5B); and HUD standards for architectural drawings and specifications (see Appendix 5E);
- vii. Review the Project Architect's certification stating that the project design complies with the Minimum Property Standards, all applicable local codes and ordinances, accessibility requirements, and HUD standards (See Appendix 5H);
  - viii. Prepare complete cost analysis and review and confirm the reasonableness of borrower's costs for design, specification, construction, contract administration and supervision (and any related due diligence or other professional services) for the construction, alteration or repair of multifamily structures (See Appendix 5I);
  - ix. Evaluate the professional liability and errors and omissions insurance for the Project Architect and borrower's other design or due diligence professionals by comparing the risks covered and the dollar amount of loss coverage to the scale and cost of construction and/or evident risks, offering an opinion of the adequacy of such coverage and confirming that such insurance will be maintained through any warranty inspection period following endorsement;
  - x. Maintain a dated log of all contacts, messages, and conversations with the Project Architect and the borrower's design team referencing all documents and versions thereof in the log;
  - xi. Ensure that all relevant parties are informed of HUD requirements and communications and coordinate responses thereto;
  - xii. Prepare or review the schedule of anticipated future capital needs and corresponding estimates of costs, assuring that all repairs and replacements likely necessary during the CNA Estimate Period are included in the analysis of future needs. (See Appendix 5G);
  - xiii. Review and confirm as part of the CNA the accuracy of estimates of replacement cost (new) for each structure (CNA eTool Property Insurance Schedule Report, the automated HUD form 92329).
  - xiv. Identify, review and describe to HUD any identities of interest among any members of the design, construction and/or due diligence team or between any such member and any principal of the borrower or between any such member and the lender;
  - xv. If the proposed application is for a green MIP rate, then all the reviews, determinations and evaluation by the Construction Analyst as described above also apply to the requirements and mandated qualifications and

procedures described in Chapter 6 for energy and water conservation measures<sup>6</sup>; and,

- xvi. Provide advice and assistance on design, construction, and physical due diligence issues to borrowers, consultants, contractors, and others.

**NOTE:** Construction analysts must apply the specific standards or criteria enumerated in the Appendices to Chapter 5. The Construction Analyst is not required to review structural design details and calculations.

### C. Scope of Work, Duties, and Qualifications for Owner’s Consultants.

#### 1. Project Architect

##### a. Qualifications

The borrower must engage an architectural professional with building design and construction expertise to prepare construction documents and to supervise construction as appropriate for the proposed construction activity. Such professional services must be provided by a licensed or registered architect or a professional engineer who must be the principal lead professional with overall responsibility for the design development and the execution of the design in construction. This professional is referred to as the Project Architect in the MAP Guide and must meet the qualifications described in this section. Failure of the borrower to engage a Project Architect acceptable to the lender and HUD is a basis for rejection of the application:

- i. License. The Project Architect must be licensed or registered by the State in which the project is located.
- ii. Experience. The Project Architect must have substantial experience in the design and construction of multifamily properties comparable in scale and scope to the proposed property and must be in good standing professionally and legally.
- iii. For green MIP rate applications, the Project Architect must meet additional experience and qualifications requirements (see Chapter 6) when acting as an energy professional.
- iv. Insurance. The Project Architect and any other consultants providing professional services for the project must be covered by an insurance policy (or policies) of professional liability, errors, and omissions.
- v. The insurance must be of an amount consistent with the risk of loss based on the scope, scale, and the total cost of the project. The amount of any payable claim shall be actual damages subject to the policy limit and shall not be limited to the fee for the service provided.

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<sup>6</sup> The Construction Analyst must review energy related reports, documentation and exhibits to ensure that HUD’s program requirements for Green MIP are met and properly documented for HUD’s review.

- vi. The professional liability insurance policy must be maintained through the twelve-month warranty inspection period that follows Final Endorsement. The professional liability insurance carrier must have and maintain a rating that is acceptable to HUD (A.M. Best Financial Strength Rating [FSR] of B+ or better).
- vii. At initial closing, each design professional must provide their current certificate of liability insurance that must substantially conform to the sample Certificate of Professional Liability Insurance contained in Appendix 5H.3.

b. Scope of Work, Duties, and Responsibilities.

The level of professional services and required documentation are determined first by the program for which the application is made and then the Classes of Work as applicable. Required services and documentation are:

- i. New Construction and Substantial Rehabilitation
  - 1) The scope of services shall provide all architectural, structural, mechanical, electrical, civil, landscape and interior design and consulting services (Design Services) necessary to prepare drawings, specifications and other documents setting forth in detail the requirements for construction of the project.
  - 2) When basic design services (e.g., civil, mechanical, electrical engineering services) are provided by professionals outside of the Project Architect's firm, they should be contracted with the Project Architect as consultants to the architect and not directly to the owner. In general, no additional Owner-Architect Agreement besides the one with the Project Architect is allowed for the design. A separate civil engineering services under a separate Owner-Architect Agreement (i.e., AIA B108) may be allowed on a case-by-case basis when warranted (e.g., when civil engineering is engaged much earlier in the predevelopment phase).
  - 3) The scope of services shall also provide for the administration of the construction contract (Construction Administration), including conducting the monthly job site meetings with meeting agendas and official recordings of the meeting minutes.
  - 4) There may be separate agreements for design and construction administration services if the same Project Architect is not employed for each (e.g., when the Project Architect has an identity of interest with the borrower). When there is a separate agreement for the administration of the construction contract, it must be submitted for approval before initial endorsement. Where separate agreements are made, those sections not applicable shall be deleted.
  - 5) The Project Architect may have an identity of interest with the owner or General Contractor, but in that event may not administer the

construction contract. Identity of interest is defined in the HUD Amendment (HUD 92408-M).

ii. Section 223(f) Transactions with High Costs and/or Complex Alterations.  
When the services of a Project Architect are required because the Aggregate Cost of the work is equal to or greater than \$15,000 per unit, or because Level 2 or Level 3 Alterations are proposed (See Chapter 5.3.C.1), the Project Architect must meet the same licensing and insurance requirements as for substantial rehabilitation, including the provision of a certificate of liability insurance that must substantially conform to the sample Certificate of Professional Liability Insurance. (See Appendix 5H.3). The Project Architect's responsibilities and liabilities apply to all alterations and repairs included in the scope of work.

iii. Section 223(f) Transaction with Green MIP.  
Refinance or acquisition applications for a green MIP rate require a Project Architect when the owner proposes to obtain a green certification to qualify for the green MIP. The Project Architect must fulfill additional responsibilities described in Chapter 6.6.C.6 and 6.7.B

c. Owner-Architect Agreement for Services.

The agreement between the architect and the owner for services must be in the form of the American Institute of Architects (AIA) Contract Documents. The owner must submit the executed contract at the time of the Firm Commitment application.

i. For new construction and substantial rehabilitation projects, the agreement must be the AIA Document B108 Standard Form of Agreement between Owner and Architect for Housing Services and must include the HUD Amendment to AIA Document B108 (HUD 92408-M).

1) In general, the document should not be altered except for the deletion of the binding arbitration and mediation provisions. The only allowable dispute resolution is litigation in a court of competent jurisdiction. Any modifications that delete or reduce the basic design and construction administration services of the Project Architect are prohibited. Further, there must be no changes that reduce, delegate, or leave a gap in the basic responsibilities of the parties involved.

2) In uncommon circumstances where it becomes necessary to describe special approved arrangements, the modifications must be noted by striking out any inapplicable language and inserting additional provisions in Article 12. Any proposed modifications will require additional review in consultation with the Office of General Counsel of HUD prior to approval.

- 3) There may be separate agreements for design and for supervisory services.
  - 4) If there is one agreement for both design and supervisory services, a specific dollar amount must be indicated for each service.
  - 5) Where the Project Architect's basic fee exceeds that which may be paid from mortgage proceeds or where the Owner-Architect Agreement provides for reimbursable expenses (note that reimbursable expenses may not be paid from mortgage proceeds or any excess contingency), the person/entity responsible for such extra fees must be identified on the HUD Amendment.
  - 6) HUD shall not be incorporated into any specific provision of the Agreement, and the inclusion of the HUD Amendment in Article 12 (enumeration of Special Terms and Conditions) is sufficient to incorporate HUD requirements. No modification of the HUD Amendment is permitted.
- ii. In Section 223(f) transactions the required professional design services are typically of limited scope. Accordingly, the Owner-Architect Agreement shall be the AIA Document B104, Standard Abbreviated Form of Agreement Between Owner and Architect. AIA B108 is allowable when the scope is extensive.
- 1) The agreement must accurately describe the specific services to be provided and include all services that are necessary to the project, including adequate construction administration duties.
  - 2) The architect's fee must be a fixed sum for the services provided. No other method of stating compensation is acceptable. Separate fee amounts for design and construction services must be stated. When the architect has no identity of interest with the sponsor or mortgagor, the design and supervision fees are mortgageable costs and should be included in the Form HUD 92264-A for the loan amount calculation.
  - 3) The AIA B104 form may not be altered in general, except for the deletion of the binding arbitration and mediation provisions. There is no standard HUD amendment prescribed for the AIA B104.
- iii. Identity of Interest. The Project Architect may be a principal or an employee of the borrower, or of an affiliate of the borrower, provided that the requirements for professional qualifications, licensing or registration, and professional liability insurance are met and that the construction documents produced are not diminished by comparison with what would otherwise be required in the AIA Contract.
- 1) The Owner-Architect agreement is still required in such cases as the design professional must be identified separately from the sponsor or mortgagor entities or affiliates, but the lender must require construction administration services by a separate, unaffiliated qualified professional. In that event, a separate AIA B 104 would be executed to

retain third party construction  
administration services during the construction phase.

- 2) No architect's fee payable to the affiliated principal or employee shall be a mortgageable cost.

## 2. Owner's Representative.

The owner must identify a representative (Owner's Representative) in the Owner-Architect Agreement and meet the following requirements:

- a. Owner's Representative must be a member of the borrower's entity, typically a general partner or managing member and may not be a third-party consultant. A prohibited third-party consultant includes a construction manager hired to act on behalf of the Owner;
- b. For Non-profit entities, the Owner's Representative may be an executive officer or a member of the Board of Directors;
- c. When a Public Housing Authority is the Owner entity or the principal thereof, the governing board or commissioner must designate a qualified individual through a passed resolution providing appropriate authority;
- d. The Owner must give the Representative the authority to make decisions in a timely manner. The Owner's Representative must be actively engaged during design and construction such as attending job site meetings and must have the authority to approve construction draw requests on behalf of the owner.

## 3. Energy Professionals.

If utility consumption benchmarking or performance evaluation is required, the owner must hire a qualified energy professional who meets the requirements in Chapter 6.4.H

### **D. Specific Qualifications, Requirements for Other Technical Specialists.**

The borrower, the Project Architect, or the lender may require the services of other technical specialists. These specialists may include sanitary, environmental, geotechnical, civil or structural engineers, etc. When engaged for services, a principal of the technical specialist firm must be a licensed or registered professional, must sign any resulting report or opinion and when applicable, must affix his/her professional seal.

### **E. HUD Approval of Qualifications.**

The lender should disclose the identity and qualifications of both the borrower's and its own architectural and construction consultants, needs assessors, energy professionals or other

technical specialists at times consistent with efficient completion of due diligence and design work but in no event later than the application for Firm Commitment. HUD reserves the right to examine credentials and experience and to reject individuals HUD deems unqualified for a particular assignment. Accordingly, the risk of relying on due diligence or design products prepared by unqualified consultants is borne by the lender and the borrower.

### **5.3 Required Professional Services, Documentation, and Oversight by Construction Activity and Program.**

HUD requires professional services, due diligence, and oversight suitable for the program and scope of work for each project. The lender and borrower must employ appropriate levels of professional services for the proposed work to ensure proper design and documentation as well as successful completion of the work. The type of professional services and their responsibilities are determined by 1) the program (Section of the Act) for which the application is submitted; 2) the Aggregate Cost of the work; and, 3) the Classes of Work proposed (see MAP Guide Chapter 5.1). Both the lender and the owner must engage qualified professionals for due diligence acceptable to HUD. See Chapter 5.2 for qualifications and responsibilities and Chapter 6.4.H and 6.7.B for green MIP applications.

#### **A. General**

##### **1. Accessibility Repairs**

When proposed repairs and alterations remedy accessibility violations, the necessity of a registered architect must be determined independently of Class of Work. In general, remedies that require simple installations or replacements of components (e.g., replacing existing non-compliant doorknobs with lever-type or installing audio-visual fire alarms) do not require an architect. However, remedies involving mandated dimensions for spaces or floor area clearances require code compliant design described in drawings and specifications (plans and specs) by a registered architect for code evaluation, precise construction, and inspection. See Appendix 5B on applying accessibility standards.

##### **2. Temporary or Permanent Tenant Relocation<sup>7</sup>.**

Lenders must evaluate the level of disruptions to tenants during construction. When the degree and duration of disruption are such that the residents need to be displaced to ensure health and safety, a relocation plan is required. See the MAP Guide Chapter 3.1.KK and Appendix 3E for instructions for acceptable relocation plans.

##### **3. Trades Bids for Section 223(a)(7) and 223(f) transactions.**

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<sup>7</sup> This applies to Section 221(d)(4) Substantial Rehabilitation as well as Section 223(f) transactions.

Repairs, Level 1 and some Level 2 Alterations typically do not require a General Contractor. Regardless of Critical or Non-Critical Repair designation, any closely related work items with an estimated Aggregate Cost of \$35,000 or greater should be based on bid(s) by a qualified licensed trade(s) contractor with the intent for the borrower to employ the trade contractor whose bid amount is selected. The borrower should execute the contract prior to closing.

4. Detailed construction schedules.

Successful construction management depends on project planning and scheduling in detail consistent with the level of construction activity and/or classification of work. General contractors are expected to provide project planning and scheduling. A detailed construction schedule must describe the necessary sequence or order of tasks, dependencies among tasks, milestones, and other important details involved for project scheduling. Typically, such a schedule is not a simple calendar but a graph or a table illustrating the elapsed time and sequence of the tasks (i.e., Gantt chart or critical path schedules).

**B. Sections 220, 221, and 231 New Construction and Substantial Rehabilitation.**

1. Scope of Work and Documentation.

- a. A Project Architect responsible for the full scope of work at the property is required. The Project Architect must fulfill all roles and responsibilities as described in the MAP Guide Section. (See 5.2.C.1.b.i).
- b. The Project Architect's drawings and specifications (plans and specs) must describe the entire scope of work involved for design permits and construction and must conform to HUD requirements for format and content of drawings and specifications (See Appendix 5E.)
- c. Lender's Construction Analyst is required to provide Architectural and Cost Analysis Reports and must fulfill all roles and responsibilities as described in the MAP Guide. (See Chapter 5.2 section B.2.b.)
- d. The lender's Construction Analyst may prepare the CNA eTool for submission based on the proposed plans and specs by the Project Architect.
- e. The use of CNA eTool is limited to scheduling and financing the future repairs and replacement of components (reserve for replacement) only. No construction work should be described in the CNA eTool as Critical or Non-Critical Repairs.

2. Construction Costs.

- a. Report costs on HUD forms for processing as described in MAP Guide Chapter 5.7.
- b. The costs of future replacement of components described in the CNA eTool should be based on the hard costs of the General Contractor's estimate/bid. All anticipated soft costs (e.g., General Contractor's general requirements, overhead, profit) should be excluded in the CNA e-Tool's estimate of components costs.

3. Schedule.

- a. A detailed construction schedule is required. (See Section 5.3.A.4 above.)
- b. HUD's Construction Progress Schedule (form HUD-5372) is not an acceptable form nor an acceptable substitute for such a detailed construction schedule described in 5.3.A.4. HUD-5372 is used to evaluate percentage of completion and the related costs and may not be used as a detailed construction schedule.

**C. Section 223(f) with Repairs and Alterations**

1. Project Architect - When Required

The borrower must hire a Project Architect to define work at the property when one of the following conditions is true of the property:

- a. The Aggregate Cost (before General Contractor fees or allowances) of all the identified repairs and alterations equals or exceeds \$15,000 per unit.
  - i. This amount of \$15,000 Aggregate Costs per unit used here as a threshold is different from the dollar per unit maximum cost that defines the boundary between Section 223(f) transactions and Section 221(d)(4) Substantial Rehabilitation. This threshold is not adjusted by the High Cost Factor or the annual inflation adjustment.
  - ii. Costs exceeding this threshold evidence that the proposed repairs and alterations are sufficiently complex that the services of a Project Architect are required to ensure the clarity and accuracy of design and specification documents necessary to guide and evaluate all construction.
  - iii. Remedies for accessibility deficiencies, if any, must be included in both the cost of repairs and alterations and the design documents.
  - iv. HUD may waive the requirement to hire a Project Architect when the Aggregate Cost of all repairs and alterations exceeds \$15,000 per unit but work is limited to repairs and Level 1 Alterations.
- b. When the Aggregate Cost of repairs and alterations is less than \$15,000 per unit but the proposed work includes Level 2 or Level 3 Alterations, a Project Architect must be retained to prepare drawings and specifications for the Level 2 or Level 3 Alterations provided as follows:
  - i. Work proposed outside the work area where Level 2 or Level 3 Alterations will occur may be excluded from the Project Architect's scope of work.; and
  - ii. When there are only Level 2 alterations proposed (no Level 3 Alterations), and the Level 2 alterations are nominal (e.g., enlarging a closet in a few units with no accessibility ramifications), the services of a Project Architect are not required.

2. General Contractor - When Required

- a. The borrower must hire a General Contractor to conduct all the work defined by the Project Architect and provide coordination as a single point of control for costs, scheduling, and conformance of the work to plans and specifications when one or more of the following conditions are true:
  - i. The Aggregate Cost of repairs and alterations exceed \$15,000 per unit, excluding General Contractor fees;
  - ii. The proposed work includes Level 3 Alterations;
  - iii. More than three licensed trade contractors are to be employed for the work.
- b. HUD may waive the requirement to hire a General Contractor when:
  - i. The Aggregate Cost of all repairs and alterations exceeds \$15,000 per unit but work is limited primarily to Repairs and Level 1 Alterations; or,
  - ii. The owner has substantial experience and proven ability planning and staging construction tasks, coordinating trades, and supplying general requirements.

### 3. Licensed Trades.

When a General Contractor is not retained, the work items documented by the architect (e.g., remedies for accessibility deficiencies, limited Level 2 Alterations) must be executed by qualified licensed trades (e.g., a plumber, electrician, framer, tile-setter licensed in the local jurisdiction). Similarly, repairs and Level 1 Alterations described as individual work items (or a group of closely related items) with an estimated cost of \$35,000 or greater must be performed by qualified licensed trades contractor(s).

### 4. Scope of Work and Documentation.

- a. All proposed work must be itemized as individual work items and descriptively listed as Critical and Non-Critical Repairs in the CNA eTool by the Needs Assessor preparing the CNA.
- b. If and when engaged, the architect must accurately describe the relevant repairs and alterations in drawings and specifications (plans and specs).
- c. The Needs Assessor must ensure that all of the work described in the architect's plans and specs are accurately summarized and described as separate work items in the Critical and Non-Critical Repairs lists in the CNA eTool with appropriate details and characterization:<sup>8</sup>

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<sup>8</sup> For example, the architect's plans show new replacement windows on the building elevations drawings indicating location and style, along with a schedule that describe types, sizes and installation details, and in specifications prescribe material and thermal performance requirements. The needs assessor should show it as a work item in the Non-Critical Repairs list describing it as window replacement, and indicate Class of Work, location, type and quantity. The needs assessor may choose to list the replacement as multiple work items, distinguished by sizes, types or other significant distinction such as location and material.

- i. The Needs Assessor should identify and reference specific sheets, pages, schedules or specifications that address the repair work item identified in the CNA eTool. This referencing should be done by entering the relevant sheet/page numbers and/or schedules as the first words in the "Comments" box in the eTool.
    - ii. The comment should direct the lender and the HUD Reviewer to the location or section of the architect's plans and specs where the listed work item is described, dimensioned or otherwise detailed.
  - d. New LIHTC 223(f) transactions typically follow a development process significantly different from other HUD 223(f) refinancing/acquisition processes and HUD waives the required use of a Needs Assessor and the CNA eTool to describe Critical and Non-Critical Repairs. Instead, LIHTC 223(f) transactions should follow construction documentation procedures similar to substantial rehabilitation (see Section 5.6).
5. Construction Costs.
- a. Costs of the work items (estimates) must be provided in the CNA eTool, except for LIHTC transactions.
  - b. When a General Contractor is hired, the costs in the CNA eTool should reflect the price proposal (bid) and the bids uploaded as attachments.
  - c. The lender must ensure that the Needs Assessor has reviewed the General Contractor's cost estimate with the assessor's own independent cost estimate.
  - d. When a Project Architect and/or the General Contractor are involved, the form HUD-2328 is not to be used to report the costs by the General Contractor for 223(f) transactions<sup>9</sup>. Instead of the HUD-2328, costs may be organized and reported in the CNA e-Tool as follows:
    - i. The contractor's price proposal (bid) should be captured in the CNA lists of repairs and alterations. The contractor's bid should be expressed as a certain dollar amount per appropriate unit of measure of the associated Alternative of the Component to be repaired or replaced.<sup>10</sup>
    - ii. Only the hard costs should be reflected in the CNA eTool Repairs lists. Soft costs, if any, should be separately itemized and reported. Soft costs include any architectural fees, General Contractors overhead, profit and general requirements, etc. See Appendix 5L for the **Lender's 223(f) Repairs &**

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<sup>9</sup> The HUD-2328 was designed to work with a full set of Project Architect prepared plans and specifications which would detail the location and extent of the work. By contrast, the CNA e-Tool relies on a different schema originating from the standard outline for CNAs established by ASTM 2018-08 and then expanded by Mortgagee Letter 2016-26 and the 2016 MAP Guide as the Estimated Useful Life Table. The two different schemes for categorizing construction work are not compatible. In addition, the HUD-2328 does not contemplate the completion of any Critical repairs prior to endorsement. For this reason, the use of the HUD-2328 in conjunction with the CNA e-Tool is unworkable.

<sup>10</sup>In many cases recommended alternatives are most appropriately expressed with "each" as the unit of measure and the bid price for each times the quantity will equal the bid total for the item.

**Alterations Cost Worksheet**<sup>11</sup> that properly organizes and reports the summary of costs.

- iii. The total cost of repairs and alterations that includes both the hard and soft costs should be reported on the HUD-92264-A, lines 7b and 10b.
- iv. No fees payable to identity of interest contractors are mortgageable. Justified and itemized general requirements are mortgageable.

6. Schedule.

- a. When a General Contractor is retained, the General Contractor must submit a detailed construction schedule as described in Section 5.3.A.4 above. The Needs Assessor must review the schedule and enter the number for “months to complete” for each work item in the CNA eTool. The number entered indicates the number of months from the initial closing until scheduled completion of the particular work item. The months elapsed is not necessarily the minimum duration of the construction for that particular item.
- b. For all other transactions the Needs Assessor and lender, in working with the owner, must develop a construction timeline that reflects the planned completion of the work items and enter in the CNA eTool as “Months to Complete.” The timeline should ensure that all the proposed work (repairs and alterations) be completed as soon as possible and within 12 months of closing.

**D. Section 223(a)(7) with Repairs and Alterations.**

1. Scope of Work and Documentation.

- a. Scope of work is limited per Chapter 5.1.E.4.
- b. All scope of work must be described and listed as Critical and Non-Critical Repairs in CNA eTool by the Needs Assessor preparing the CNA.
- c. When the Critical Repairs include accessibility repairs, the Needs Assessor must assess and recommend to the lender whether an architect is required per Chapter 5.3.A.1. Needs assessor may provide architectural services when the person is a registered architect.
- d. The plans and specs, when produced to address accessibility remedies, must be submitted with the CNA eTool as attachments.

2. Construction Costs. Costs of the work items must be provided in the CNA eTool.

3. Schedule. A construction schedule must be provided in the CNA eTool indicated as “Months to Complete” for each work item.

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<sup>11</sup> The worksheet provides a printable summary of costs best suited to assure that program cost limiting thresholds are correctly applied and that a common report of scope of work and related costs exists for all parties, including HUD reviewers and inspectors. A sample worksheet summary of cost is provided in Appendix 5L. Editable spreadsheet will be provided for download at HUD MAP Guide Website.

## 5.4 Architectural Standards and Other Criteria

Projects that are built, substantially rehabilitated, acquired or re-financed with FHA mortgage insurance must meet the standards described in the Appendices to this chapter, as outlined below:

- A. Appendix 5A – Common HUD Standards and Criteria
- B. Appendix 5B – Accessibility for Persons with Disabilities
- C. Appendix 5C – Seismic Resistance and Fire Protection Standards for Existing Buildings
- D. Appendix 5E – Firm Commitment Drawings and Specifications to be submitted by the Borrower’s Architect
- E. Appendix 5G– Capital Needs Assessments

## 5.5 Construction Contracts

### A. New construction and Substantial Rehabilitation.

New construction and substantial rehabilitation projects require a General Contractor and the services of a Project Architect (See 5.3 above.) The contracts between the parties must be coordinated using the following forms:

1. Owner and General Contractor.
  - a. The construction contract between the Owner and General Contractor shall be form HUD-92442M Construction Contract for Insured Advances:
    - i. Form HUD 92442M, Construction Contract Lump Sum (Article 4 Option 2), may be used when there is no identity of interest between the borrower and the contractor.
    - ii. Form HUD 92442M, Construction Contract Cost Plus (Article 4 Option 1), may be used in any case, and shall be used when an identity of interest exists between the borrower and contractor. A Builder’s Profit will not apply.
  - b. Form HUD-92554M Supplementary Conditions to the Contract for Construction attached.
  - c. AIA Document A201-2017 General Conditions of the Contract for Construction attached.

- d. The construction contract for Insurance Upon Completion projects may or may not be the Contracts and Forms listed above. However, some form of binding contract must be executed and submitted to HUD for review and approval.
2. In addition, the Building and Loan Agreement between the borrower and the lender (HUD 92441M) must be used.

**B. Section 223(f) transactions.**

The use of contracts depends on the required professional services (see 5.3 above). Whenever an architect and/or General Contractor is engaged, the contracts must be in writing using the forms acceptable to HUD as follows:

1. The Owner and General Contractor agreement shall be AIA A104, and;
2. Other AIA forms for change orders, requisitions of funds, and related processes referenced in these paired agreements should be used consistent with the terms of the agreements.

## **5.6 Streamlined Processing For Projects with Low Income Housing Tax Credit (LIHTC) and Other Qualified Applications**

**A. Applications Eligible for Streamline Processing.<sup>12</sup>**

1. Streamline processing means that less than 100% complete plans and specifications (construction documents) may be submitted with the application for Firm Commitment.
  - a. Proposed final project drawings and specifications must be submitted for HUD’s review and comment/approval at least thirty calendar days prior to initial endorsement.
  - b. Any HUD comments on the proposed final drawings and specifications must be resolved and permit-ready drawings and specifications<sup>13</sup> must be delivered not less than ten calendar days prior to initial endorsement.
2. All LIHTC project applications are eligible for streamlined processing of design and

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<sup>12</sup> Streamlined processing of architectural design, specification, construction, and cost estimation exhibits serves two purposes. The first is to expand the use of HUD mortgage insurance programs for projects with Low Income Housing Tax Credits (LIHTC). The second is to expedite applications for borrower development teams with clearly demonstrated capacity and experience with HUD-insured construction projects.

<sup>13</sup> “Permit ready” means approved by the Building Code Official with jurisdiction, subject only to the payment of required permit fees and charges.

construction documents.

3. Other applicants requesting streamlined processing should describe and discuss their qualifications with the MF Regional Center/Satellite Office for approval.
  - a. HUD will discuss and determine eligibility for streamline processing at the concept meeting or pre-application stage.
  - b. To be considered qualified, the borrower/sponsor, the Project Architect, the General Contractor and due diligence providers must each have successful prior HUD project experience comparable in scope and scale to the scope of work proposed in the application.
  - c. Applicants for 223(f) without LIHTCs and with repairs and alterations requiring a Project Architect may request a concept meeting if they consider deferred submission of final plans and specifications necessary.
4. Factors Limiting Streamline Processing for Non-LIHTC Applications.
  - a. Lenders and MF Regional Center/Satellite Offices should determine that the project will achieve initial closing within sixty calendar days after issuance of a Firm Commitment conditioned upon final plan submission.
  - b. Lenders and MF Regional Center/Satellite Offices should consider the complexity of the proposed design and construction when determining whether to permit the deferred submission of final drawings and specifications. Complex issues unsuited to streamlined processing include, but are not limited to:
    - i. Any claim of exemption from the design and construction requirements of the Fair Housing Act based on site impracticality (terrain unsuited to accessible paths and building entrances);
    - ii. Projects where costs not attributable to residential use must be calculated because Criteria 4 of the form HUD 92264A, Statutory Limitations of cost per family unit is material to the calculation of the maximum mortgage amount;
    - iii. Projects with complex mixed-use, commercial use, or use of new, complex construction technology;
    - iv. Projects with complex environmental remediation issues or issues that cannot be resolved without the final set of plans and specifications (e.g., noise, historic preservation).

**B. Processing Instructions for Section 223(f) with new LIHTC Applications.**

New LIHTC 223(f) transactions have a largely, if not fully, developed scope of work for repairs and alterations early in the development. Accordingly, a separate CNA should not be needed to evaluate property conditions or to define the scope of work for repairs and alterations and HUD will waive the required use of Needs Assessors and the CNA eTool to describe Critical and Non-Critical Repairs. Applicants for 223(f) insured loans with new tax credits should follow the following construction documentation procedures:

1. The construction scope of work should be defined by the Project Architect in a full set of construction drawings and specifications as prescribed for substantial rehabilitation, provided that the Architect's Agreement will be the AIA B104 and the Architect's Certificate shall be in the form of Appendix 5H.2.
2. A General Contractor should be engaged and should estimate costs using the form HUD-2328. The general contract should be the AIA A104.
3. The Project Architect should provide to HUD a written summary documenting the inspection procedure employed at the property and identifying conditions or systems determined to require correction, repair, replacement or improvement, similar to what is described in Chapter 5.9.B.2 for Joint Inspection Report.
  - a. This written summary is in lieu of a Needs Assessor inspecting and reporting on the property.
  - b. Specifically identify any conditions that fail to meet the applicable accessibility requirements at the property for persons with disabilities under relevant statutes: Section 504 of the Rehabilitation Act, the design and construction requirements of the Fair Housing Act and the Americans with Disabilities Act both Title II and Title III.
  - c. A comparable document prepared for the application for tax credits or for the tax credit investor may be acceptable.
4. The CNA eTool should only describe future repairs and replacements for purposes of establishing the appropriate Reserve for Replacement Schedule including any initial deposit to the Reserve and annual deposits to the Reserve Escrow. The characterization of future needs should be based on project conditions assuming completion of all work described in the Architect's plans and specifications.
5. The lender must employ a Cost Analyst to review the plans and specifications and the General Contractor's cost estimates (and likely also to prepare the CNA eTool for future needs). The cost review should be completed using the same methods, procedures and forms as applicable to substantial rehabilitation applications, including HUD forms, HUD-92326 and HUD-92331-B.
6. When reviewing costs of repairs and alterations, the lender should ensure that the sum of hard costs, the General Contractor's soft costs and the Project Architect's supervision fee, and any contingency or assurance of completion do not exceed the cost threshold for substantial rehabilitation. Any contingency or assurance of completion amounts must be included into the Aggregate Cost calculation per Section 5.1.B.<sup>14</sup>
7. All other construction documents should be submitted separately consistent with procedures for substantial rehabilitation.

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<sup>14</sup> This restraint should be imposed at the time of application for firm commitment because LIHTC investors customarily require that contingencies or assurance of completion funds are fully used, first for necessary change orders, and then for betterment change orders. There is no expectation that funds will be returned to the borrower.

8. Attachments to Firm Commitments should be consistent with the practice for insured substantial rehabilitation and in compliance with the specific instructions provided in this Section.

**C. Minimum Construction Documentation at Firm Commitment.**

The Firm Commitment may be conditioned on the timely receipt and satisfactory review of complete and final plans, specifications and cost estimates, provided that the lender's submission of less than 100% of the drawings, specifications (i.e., schematic/line/working drawings) and cost estimates provide the following detail:

1. The static footprint of the building or buildings together with proposed site improvements on the surveyed site plan as well as any proposed easements and/or off-site improvements with survey detail consistent with the requirements for surveys described in Appendix 5A;
2. The gross building and net residential square footage for the project;
3. Dimensioned unit layouts for each unit type for new construction or substantial rehabilitation or for reconfigured spaces in Section 223(f);
4. Dimensioned floor plans, and elevations for each building type;
5. Sufficient design detail to determine the Davis-Bacon wage rate classification for new construction and substantial rehabilitation;
6. Sufficient design detail to determine compliance with accessibility requirements in Appendix 5B;
7. Sufficient design detail (wall cross-section details) to determine structural framing and exterior wall finishes for new construction and substantial rehabilitation and other repairs and alterations when applicable;
8. A summary interior finish schedule identifying proposed interior finishes for units, including kitchens and baths, as well as for building common spaces and accessory structures;
9. Sufficient design detail to determine building mechanical systems;
10. Sufficient design detail to determine the scope of site development and off-site construction;
11. A written cost estimate (HUD-2328) from the General Contractor, if any;
12. The lender's Construction Analyst's cost estimate (HUD-92326);
13. The lender's review and comparison of the General Contractor's cost estimate with the lender Construction Analyst's estimate on form HUD-92331;

14. For new construction and substantial rehabilitation (a) the proposed but unsigned owner-contractor agreement for construction (HUD-92442M) indicating any selected options (e.g., incentive payments) or special conditions and the Supplemental Conditions (HUD-92554M). For Section 223(f), the AIA A104, if General Contractor is used;
15. Project Architect's or Needs Assessor's CNA reviewed by the lender's Construction Analyst with the lender's financial plan for funding future capital needs, all in accordance with Appendix 5G. Such CNA may be based on less than 100% complete construction documents and be amended at the time the 100% set is submitted;
16. Applications in pursuit of Green MIP rate must have plans and specs at the level of completion that the chosen Green Certification standard keeper is able to verify achievement(s) of required milestones and be on track to achieve the actual Certification within required timeline.
17. For substantial rehabilitation, the Project Architect's detailed inspection report and work write-up.

**D. Scope of HUD Review and determinations required in order to issue a Firm Commitment:**

1. An assessment that the estimated project cost based on the borrower's or General Contractor's estimate of costs and the lender's cost estimate and the lender's comparison of these estimates is reasonable and in line with comparable HUD project data and is likely accurate within a deviation of plus or minus 5%;
2. An assessment that the borrower's and General Contractor's financial capacity to complete the proposed construction is not materially diminished by an increase in cost of up to 5%;
3. An assessment that the proposed General Contractor is acceptable pursuant to existing requirements (sufficient working capital, experience, etc.);
4. An assessment that the plans and specifications are in compliance with all applicable requirements on a preliminary basis, with appropriately qualified certifications executed; and,
5. The Phase I (ASTM Practice E 1527-13 or most current) environmental site assessment and the HEROS Environmental Report must contain no significant unresolved environmental issues (see Chapter 9).

**E. A modification must be made to the Firm Commitment** for those projects determined to be eligible for deferred submission of final drawings, specifications and cost estimates. Below is a sample special condition to be added to the Firm Commitment.

*“As an accommodation to the Borrower, this commitment has been issued and based upon preliminary drawings, instead of the final drawings, specifications and cost estimates. At*

*least 30 days prior to the scheduled date for Initial Endorsement [Endorsement, if pursuant to 223(f)], HUD must receive the final drawings, specifications and the lender's architectural/cost review report for review and approval to ensure consistency of design and cost. In the event that there is a net cumulative construction cost change of more than 5%, or a change in design concept, this commitment shall be subject to and conditioned upon the further approval of HUD, to be evidenced in writing. Based on such review this commitment may be terminated and voided by HUD, or additional conditions may be imposed, at HUD's option."*

- F. All risks related to deferred submission of construction documents** are borne by the lender and the borrower. HUD will not refund application fees in the event that borrower is unable to provide acceptable construction documents

## **5.7 Standard Processing for New Construction – Concept Meeting through Firm Commitment Application**

- A. Concept Meeting. When a concept meeting is scheduled, its purpose with respect to design and construction topics is to establish feasibility and to identify key issues. For this reason, the lender should provide:
1. The name, address, contact information and resume or summary of experience of the Project Architect and any other design professional(s), due diligence providers and the General Contractor if known. Of particular importance is the development team's previous experience with HUD mortgage insurance programs for new construction.
  2. Maps and photographs illustrating the location, boundaries, conditions, and features of the site, noting, in particular, the location and size of public utility lines available to serve the site, means of access and egress, and proximate properties. Such survey of the site should identify key issues presented by the site and its environs, such as, but not limited to:
    - a. Terrain, rock or steep slopes that may require detailed exploration, unusual site costs or result in any claim of site impracticality exemption from the design and construction accessibility requirements of the Fair Housing Act.
    - b. Absence or unavailability of public utilities, required offsite work, unusual public permitting or development entitlement processes or costs.
    - c. Insufficient or deficient access to site due to limitations on existing streets and grades or lack thereof and/ or adverse traffic patterns or conditions.
    - d. Flood plain or flood hazard areas and the location of recognized environmental conditions that indicate the presence of contamination as defined by ASTM E 1527, or protected sites or artifacts.
  3. The borrower's summary design program or concept prepared after inspection of the site and preliminary review of existing or proposed zoning, subdivision, and building code

requirements. The summary should characterize the contemplated number, size, and kind of buildings and dwelling units and should include a conceptual site plan and sketch plans of typical units and buildings.

4. The lender should describe existing or ongoing needs for site due diligence and provide a plan or description of how due diligence tasks will be completed, including appropriate sequencing, coordination of studies, and the identity of prospective providers. The lender should include a discussion of environmental issues and plans to address them.
5. The lender should identify any other contemplated sources of funding that would trigger design and/or construction requirements and describe such requirements (e.g., any Federal assistance, such as HOME, will trigger Section 504 and UFAS; state or local assistance, including LIHTCs, may trigger a state or local agency plan for compliance with Title II of the Americans with Disabilities Act).
6. The lender should state whether streamlined processing of design and construction documents is proposed and, if proposed, the reasons such processing is both needed (e.g., use of LIHTCs is expected) and realistic (e.g., development team is experienced with HUD-insured mortgage programs for construction, has successfully executed physically similar projects, and the site and/or environs present no complex challenges or prospective delays).

#### **B. Pre-Application.**

The lender's underwriter must have visited and inspected the site, and the lender must submit the following Pre-application exhibits to HUD:

1. Form HUD-92013, Application for Project Mortgage Insurance.
2. Location map with property clearly defined.
3. Sketch plan of the site showing overall dimensions of main building(s), major site elements (e.g., parking lots, points of access and egress, pedestrian access, and accessible entrances and paths) and location of existing utilities (e.g., water, sewer, electric, gas) in the streets adjacent to the site.
  - a. Contour lines and elevations are not required in the sketch site plan. However, the lender must state whether any contours or elevations observed are likely to result in a claim of exemption of any proposed building or facility from the design and construction requirements for accessibility of the Fair Housing Act by reason of site impracticality (See Fair Housing Design Manual 1.38).
  - b. If so, the lender must confirm that it has advised the borrower, the design professional(s) and the General Contractor of the site feasibility methodology described in the Fair Housing Act Design Manual. Similarly, the lender must describe whether and how any design and construction requirements triggered by other sources of funding (e.g., UFAS or the 2010 ADA Standards for Accessible Design) will be met.

4. Sketch plans of building(s) that show:
  - a. Ground floor plan showing common areas and dimensions;
  - b. Building floor plans showing unit types, placement, and dimensions;
  - c. Unit floor plans of all unit types;
  - d. Building elevations;
  - e. Residential and gross building area for each building or building type;
  - f. Typical wall sections showing footing, foundation, and wall and floor structure, with notes indicating the basic materials to be used in the structure, floor, and exterior finishes; and
  - g. Anticipated interior finish schedule indicating kind and quality of finishes proposed for units, including kitchens and baths, as well as building common spaces and accessory structures.
5. The lender must address any physical due diligence issues identified and ongoing due diligence needed to complete analysis of the site and its environs. If not addressed at a concept meeting, the lender should provide a description of the studies completed or anticipated and the identity of those preparing the studies. Completed or proposed due diligence should include investigation of the physical requirements that may be imposed by any other sources of funding anticipated for the project.
6. See Chapter 9 for environmental review requirements.

**C. Firm Commitment Application.**

The lender's Construction Analyst must have visited and inspected the site and its environs, investing time and attention to detail sufficient to allow the analyst to appreciate due diligence needs and to knowledgeably evaluate prepared due diligence and all design and construction documents. The lender must submit the following exhibits for review, provided that, if the application is approved for streamlined processing, the following exhibits may be submitted as substantially completed drafts and resubmitted as proposed final drafts at least 30 days prior to an initial endorsement (See 5.6 above):

1. Form HUD-92013, Application for Project Mortgage Insurance.
2. Owner-Architect Agreement, AIA Document B108 (and HUD Amendment to the B108), fully defining the services and fees for each prime design professional with which the borrower/owner contracts directly. The Project Architect shall have the authority and duty to coordinate all the consultants and their work involved in the basic design services of the architect.
3. Completed Surveyor's Report, Form HUD-91073M, with responses to all questions and the completed HUD certification. See Appendix 5A.
4. Engineering and specialty reports (e.g., geotechnical, structural).

5. Municipal and utility company letters of confirmation for the provision of services and/or offsite improvements.
6. Any documents necessary to establish:
  - a. Site ingress and egress, utility services and other general acceptability criteria in MPS 4910.1, Chapter 2.
  - b. Binding or signature-ready drafts of proposed joint use, access and maintenance agreements where common use easements (e.g., common driveways) exist or are proposed. When proposed, easements should be platted, and agreements drafted for review in preparation for recording.
7. Certification from Project Architect substantially in the form of Appendix 5H.1.
8. Drawings and Specifications. One legible full-sized printed set (hard copy) of drawings and one set of specifications for review that conform to the specific format and requirements described in Appendix 5E.
9. Offsite Construction: Description of all work essential to the project but outside the boundaries of the property (see Appendix 5E).
10. The General Contractor's Cost Breakdown, form HUD 2328.
11. The lender's CNA based on construction plans and specifications of the improvements to be built. A qualified energy professional must be engaged to complete the section "a" below, as required for green MIP applications (See Chapter 6). The lender's Construction Analyst or the Project Architect may complete the remaining three sections "b," "c," and "d." The Project Architect should verify the accuracy of the information reflected in these sections according to the latest plans and specifications developed by the Project Architect. The CNA must be completed and submitted using the CNA eTool in accordance with Appendix 5G and includes:
  - a. For green MIP applications, a HUD Custom Statement of Energy Design Intent (SEDI) from EPA's Portfolio Manager based on projected utility consumption for the entire property to be built, including the entire site and all the buildings. The projected utility consumption data resulting from the Energy Modeling should be reported to Portfolio Manager and the HUD Custom SEDI obtained. The resulting HUD Custom SEDI must show an energy score not less than the prescribed minimum per applicable program requirements. (See Chapter 6.) Note that the HUD Custom SEDI minimum score is a requirement in addition to, and not in lieu of, the obligation to prepare plans and specifications meeting the requirements of the applicable version of the International Energy Conservation Code or the ASHRAE standard 90.1. See Chapter 6 for more details.
  - b. A completed physical inventory of the property to be built, (that is, description of the site, buildings, units, utility types and rates, components and alternatives in the CNA eTool).
  - c. An estimate of replacement cost, as new, for each structure (form HUD 92329, Schedule of Insurable Values, automated in the CNA eTool). The Aggregate Costs

should be consistent with the lender's Construction Analyst's estimate of costs for structures including general requirements, contractor's overhead and profit, and bonding.

- d. The lender's financial plan for funding future capital replacement needs based on actual expected replacements with appropriate adjustments for inflation and other variables as described in Appendix 5G. The financial plan will define the schedule of annual deposits to the Reserve for Replacement escrow.
12. The lender's Construction Analyst's detailed cost estimate package (Cost Report) composed of the following:
    - a. Detailed cost estimate to be reported on Form HUD-92326.
    - b. A comparison of the General Contractor's trade line item cost estimate (HUD-2328) with the lender's Construction Analyst's estimate (HUD-92326) with comments and explanations described on form HUD-92331-B.
    - c. The lender's Construction Analyst must sign and date the HUD-2328 in the FHA: Processing Analyst box. The lender's underwriter must sign and date the HUD-2328 in the FHA: Chief Cost Branch or Cost Analyst box.
  13. The lender's Construction Analyst must sign and date the HUD-92264 submitted by the lender as both "Cost Processor" and "Architectural Processor." If different analysts execute the architectural and the cost reviews, then each must sign as appropriate.
  14. The lender's Construction Analyst's review and disclosure of identities of interest and application of the 50%-75% Rule (See Chapter 13, sections 13.16.M and 13.17 for instructions on this Rule.):
    - a. Identify and describe any identity of interest relationships between or among the Borrower, any of the Borrower's design professionals, the General Contractor, any subcontractors, material suppliers, equipment lessors, or manufacturers of industrialized housing.
    - b. Identify by analysis of the HUD 2328 any single subcontractor that executes 50% or more of the total construction or any three subcontractors who in the aggregate execute 75% or more of the total construction measured by dollar value.
  15. The proposed but unsigned owner-contractor agreement for construction (HUD-92442M) indicating any selected options (e.g., incentive payments) or special conditions and the Supplementary Conditions (HUD-92554M) reviewed and included in the lender's Construction Analyst's report.
  16. Review report prepared by lender's Construction Analyst who must state that all exhibits are acceptable without conditions, and that all deficiencies have been acceptably corrected, except that in the case of an application approved for streamlined processing, this statement may allow for the contingency that final plans and specifications have not been completed and that final cost estimates may vary by up to 5% from the costs estimated in the Firm Commitment application. The report should address the following:

- a. Completeness of construction documents;
- b. Conformance to local building codes and HUD standards, including the HUD minimum energy codes when these exceed local code requirements;
- c. Accessibility for persons with disabilities. Refer to the Fair Housing Act design and construction requirements for accessibility found at 24 CFR 100.205. If the property is federally assisted, refer also to the Uniform Federal Accessibility Standard (UFAS). For any public space at the property (e.g., leasing office, commercial space), refer to Title III of the Americans with Disabilities Act (See Appendix 5B).
- d. Site design:
  - i. Placement of buildings, roads, walks and parking on the site;
  - ii. Identification and review of offsite construction;
  - iii. Site erosion and storm drainage; and
  - iv. Soil borings report.
- e. Building design and building circulation:
  - i. Adequacy of elevators;
  - ii. Number and placement of stairs;
  - iii. Adequacy of lobbies and corridors; and
  - iv. Adequacy of fire egress.
  - v. Typical dwelling units: Adequacy of room sizes and circulation within units.
  - vi. Fire safety: Provision of adequate fire safety measures, e.g., fire sprinklers, firewalls, fire doors (if required).
  - vii. Structural adequacy: Review of building structure and structural details including measures implemented to address identified hazards such as seismic risk, coastal high wind and/or flood zones.
  - viii. Mechanical, electrical and plumbing adequacy: Review of mechanical and electrical and plumbing plans.
  - ix. Energy efficiency. Review utility combination for energy efficiency and determine acceptability of utility combination. Review and submit the Capital Needs Assessment in the CNA eTool per Appendix 5G and confirm that the HUD Custom SEDI shows an energy score of 60 or better. See Appendix 5D for applicable International Energy Conservation Code and ASHRAE standards for new construction.
- f. Submit copies of the lender's Construction Analyst's project files and logs only if requested by the HUD Office.
- g. Standard certification by lender's Construction Analyst(s) (see Chapter 11 Section 11.2).

17. See Chapter 9 for environmental review requirements.

**D. Special Considerations in Industrialized Housing (New Construction).**

The lender must contact the Production Chief of the Multifamily Regional Center or Satellite Office to approve the use of industrialized (aka “modular”) housing. Architectural and engineering services are required for off-site construction of housing (modules or panels) and the fees for such services must be included in the cost of each manufactured unit. The lender’s Construction Analyst must determine the acceptability of such services by examining the drawings and specifications. In addition, architectural services are required for on-site construction including site work and a prepared foundation for the installation on-site of modules or panels constructed off-site. These services are provided by the Project Architect.

1. The exhibits for off-site work shall be equal in quality to the typical construction documents prepared by architects engaged in designing the type of housing proposed and should include the working drawings and specifications for the typical industrialized housing unit, along with an assembly or installation plan and manufacturer’s warranty document which must cover not only off-site construction but also transit and delivery and the efficacy of the on-site assembly or installation plan.
2. Additional professional services may be required to provide a complete set of construction documents. These services must be determined by the lender’s Construction Analyst for each project based on the percentage of the construction documents for the project that may be provided by the housing manufacturer. Usually, the Project Architect will integrate the manufacturer’s drawings into his/her set of drawings and specifications, adapting them to the particular project.
3. The manufacturer shall provide complete professional design services for the modules or panels to be used. If these services in combination with those of the Project Architect meet in all respects the qualifications and quality required, the construction documents shall be acceptable.
4. In most states, plans and specifications for industrialized or manufactured housing are pre-approved by an authorized state office, agency or building code official with plans for particular models evidenced by a plan approval number. Inspections and or certifications of factory-based construction typically are managed by states by periodic factory inspections evidenced by stamps and/or numbered approvals. It is the responsibility of the Project Architect, reviewed by the lender Construction Analyst, to determine that any and all plan approvals have been obtained.
5. Owner Architect Agreement, AIA Document B108, is required only to cover the services provided by the Project Architect and is not required for professional services provided by the housing manufacturer.
6. In all cases, an independent architect with no identity of interest shall provide general administration of the construction contract.
7. The logistics of construction with modules constructed off site require detailed consideration as part of construction planning and should be well understood as early as the concept meeting. In urban areas large modules trucked to a construction site must negotiate narrow streets, power lines, trees and related obstacles and often cannot be stored in

quantity. Cranes and heavy lift equipment may also be required and may confront similar constricted access challenges. These logistic requirements may impose additional costs and scheduling problems and may limit feasibility.

8. In addition, modular manufacturers typically require a minimum payment or deposit to initiate or complete work on a modular unit off-site. Such fees are credited to the owner or General Contractor upon delivery of the modular units. But until units are delivered, these payments or deposits are not reimbursable as part of an insured advance. Only the costs of modular units delivered, accepted by the General Contractor and installed or stored on-site or in an acceptable, owner-controlled location proximate to the construction site and covered by the owner's or General Contractor's builder's risk insurance may be included in an insured advance.
9. Davis-Bacon Wage will apply only to the onsite construction work.
10. Loan term for industrialized housing must be based on proper assessment of the economic life of the project as determined by the appraiser (See Chapter 7) given the construction quality and material used.

## **5.8 Standard Processing for New Construction – Firm Commitment through Initial Endorsement**

### **A. Plans and Specifications Revisions.**

Except for projects submitted as streamlined applications, drawings and specifications may be amended by addendum when the change(s) will have no effect on cost or value (final drawings and specifications are finalized after Firm Commitment in streamline processing.) The lender's Construction Analyst must review the addenda for acceptability as follows:

1. Addenda must clearly state or show the change with specific reference to the location of the item on the drawings or in the specifications.
2. Amendments shall be clearly noted and dated.
3. Addenda are not to be used to correct errors noted during Firm Commitment processing.

### **B. Major Changes.**

Firm commitment reprocessing is required for major changes adding or deleting work representing a net change of more than 5% of estimated total construction costs, or physical changes that alter underwritten income and expense so as to change the approved mortgage amount by a sum greater than 5% of total construction cost. Drawings and specifications affected must have sheets and pages revised and replaced.

**C. Construction Documents.**

The lender shall submit the following construction documents to HUD for review and approval prior to initial endorsement:

1. Final, signature-ready drafts of the Building Loan Agreement, Form HUD-92441M, the Construction Contract, Form HUD-92442M and the Supplementary Conditions to the construction contract (HUD 92554M).
  - a. Ensure the correct identification of drawings and specifications on contract forms.
    - i. Project name, HUD project number, and Project Architect's name.
    - ii. Drawings and specifications by sheets, pages, and date or by index with date of last revision of sheet and page.
    - iii. Addenda, if any, by number and date.
  - b. Ensure compliance with any architectural requirement or condition.
2. Survey and Surveyor's Report, Form HUD-91073M, which must be reviewed:
  - a. For compliance with Survey Instructions and Certificate.
  - b. To confirm that the legal description and survey property boundaries agree.
  - c. To confirm consistency of the approved plans and site plan with the survey and the description of any easements, joint use and access agreements, dedications of land for public rights of way, and state or local subdivision requirements.
  - d. The Survey (plat) shall be full-sized hard copy.
3. Contractor's Estimated Progress Schedule. Article 3.10.1 of the AIA General Conditions requires the General Contractor to prepare and submit an "estimated progress schedule for the work" to the borrower and Project Architect. (See instructions for how to prepare the progress schedule in this Chapter at 5.3.A.4.)
  - a. The borrower or Project Architect must submit a copy to the lender's Construction Analyst at least 30 days before initial endorsement, and a final copy must be provided with the permit-ready drawings not later than 10 days prior to endorsement.
  - b. The lender's Construction Analyst must review the schedule to ensure it relates to all the construction activities required by the construction documents, including dates for the stages of construction.
  - c. Copies of the approved schedule are distributed with other construction documents at initial endorsement and used to monitor construction progress.
4. Drawings and Specifications. Submit three sets and confirm that:

- a. Master Sets No. 1, 2 and 3 are the same as accepted and identified in the Firm Commitment. (For projects approved for streamlined processing, the lender must confirm that the final plans and specifications are acceptable, complete and consistent with Firm Commitment exhibits.) Indicate the total number of pages in the drawings and specifications. HUD may, at its discretion, eliminate the requirement for set No. 2 (HUD review set).
  - b. Cover and last drawing sheets, and the first and last specification pages of all sets, are signed by representatives of the Project Architect, architect administering the contract, owner, contractor, lender, and bonding company, if any.
  - c. Master Set is bound and signed as described above on the cover sheet and last sheet of the drawings and the first and last pages of the specifications. Signatories must initial opposite any “last minute” revisions not covered by Firm Commitment or addendum. The master set must be identified as such.
  - d. Lender’s signatory is an individual or individuals who are authorized to sign at closing, and who must sign and initial the plans and specifications (see Appendix 5E). HUD will accept only the lender’s authorized signatory, who must be identified as such for HUD by the lender.
5. Drawings and Specifications. The lender must retain one set and confirm that the:
- a. Lender set is the same as the set that was accepted and identified in the Firm Commitment (or approved after Firm Commitment per streamline processing). Indicate the total number of pages in the drawings and specifications.
  - b. Cover sheets are signed by representatives of the Project Architect, architect administering contract, owner, contractor, lender, and bonding company, if any.
  - c. Lender set is signed by signatories on the cover sheet and the last sheet of the drawings and the first and last pages of the specifications. Signatories must initial opposite any “last minute” minor revisions not covered by Firm Commitment or addendum or as approved per streamline processing.

**D. Recommendation for Initial Endorsement.**

If construction documents are correct, the HUD senior underwriter will recommend initial endorsement. In the event of errors or inconsistencies, the construction documents will be returned to the lender for correction and resubmission.

**E. Distribution of Drawings and Specifications.**

1. After initial endorsement, the lender shall distribute the drawings and specifications as follows:
  - a. Set No. 1, The Master Set, is the legal contract document. The lender shall deliver the Master Set to the HUD office (Regional or Satellite office) that will oversee the construction. Prior to closing, HUD will inform the lender which HUD office will receive the set. HUD will:

- i. Retain this set until the last guarantee inspection.
      - (a) Add a copy of each change order, form HUD-92437.
      - (b) Add a copy of each architect's supplemental instruction.
    - ii. HUD staff will use this set for processing change orders, review of inspection reports and similar functions.
    - iii. Package the specifications in a tightly-rolled bundle with drawings on the outside, attach a memo indicating the HUD project number, and send it to the Regional Federal Records Center one year after completion of construction.
  - b. Set No. 2 is the Contractor's Set.
    - i. This set is to be delivered to the Contractor to be kept on site.
    - ii. This set will be the Contractor's "record set," where the Contractor will record any updates during construction as "as-built."
  - c. Set No. 3 is the HUD Inspector's Set.
    - i. The HUD inspector will use this set for inspection of the project.
    - ii. The HUD inspector will conform this set to the contractor's "record set." (The Contractor is required to maintain at the site a record set for the Owner.)
    - iii. The HUD inspector will return this set to the HUD office upon completion of construction. This set will be the HUD "as-built" set.
    - iv. Use this set for guarantee inspections.
    - v. HUD Inspector will send the "as-built" set to the HUD Regional Center/Satellite Office Director, one year after completion of construction, for use in loan servicing.
2. Drawings and specifications to be maintained by the lender (the "Lender Set"):
  - a. In addition to the prescribed sets above, the lender must maintain an additional set for a period of three years after final endorsement.
    - i. Add a copy of each change order, form HUD-92437.
    - ii. Add a copy of each architect's supplemental instruction(s).
    - iii. The lender may choose to keep electronic copies of the above documents. It is recommended that the lender also maintain copies of HUD Trip Reports and other related documents distributed during the construction period.
  - b. If the originating lender will not administer the construction contract, the construction administering lender must forward copies of each change order and architect's supplemental instruction to the originating lender for inclusion in the Lender Set.

**F. Early Start of Construction.**

Construction work to be performed after receipt by HUD of the initial application but before initial endorsement constitutes an early start of construction. An early start of construction is prohibited in general but may be allowed only with the prior approval of the Director of the MF Regional Center/Satellite Office on a case-by-case basis.

Examples of permissible early start construction include minor clearing, grading, demolition, environmental remediation and other preliminary site work that are not substantial in scope. In some cases, site improvements or grading work on a neighboring site might result in necessary adjustments to surface drainage or grades on the subject site which may be deemed permissible. Similarly, utilities serving multiple proximate parcels might require installation of a main across the subject site and such work also may be permissible. Any requests for approval of early construction must be submitted during the review stage of the application. No work shall proceed without either a HEROS environmental review or a determination that one is not necessary and the borrower obtaining and evidencing all state or local approvals or permits requisite for that work.

The following are mandatory conditions for approval of an early start of construction:

1. Firm Commitment. There must be a valid outstanding Firm Commitment, including:
  - a. Site control and/or ownership of the land that will ensure the right to legally access the site for purposes of construction.
  - b. HUD-approved set of contract drawings and specifications on file. See Appendix 5E for required Firm Commitment contract drawings and specifications.
  - c. Required construction contract and other construction documents, including, but not limited to:
    - i. Construction contract, form HUD-92442M;
    - ii. Supplementary conditions of the contract for construction, form HUD-92554M;
    - iii. applicable Davis-Bacon wage decision (supplied by HUD Labor Standards and Enforcement);
2. Assurance of Completion for On-Site and Off-Site Work. The early start may not hamper the ability of the borrower to obtain a good and marketable title policy when the loan goes to initial closing.
3. Valid Basis for Early Start. The MF Regional Center/Satellite Office Director must document the file including the reason for granting an early start, after determining that:
  - a. An immediate closing is not practical.
  - b. There is reasonable evidence and assurance that closing will occur in the near future.
  - c. There is a compelling need to start construction before the anticipated closing date.
  - d. An early start of construction will not be detrimental to HUD's interests.

- e. HUD has no insurance obligation or liability whatsoever for costs incurred during an early start if the project does not reach initial endorsement.
4. The contractor, borrower and lender must execute Form HUD-92415, Request for Permission to Commence Construction Prior to Initial Endorsement for Mortgage Insurance, without change. The MF Regional Center/Satellite Office Director must sign form HUD-92415.
5. The costs involved for the early start work must be included and reflected as relevant in the line items of the contractor's cost estimate form HUD-2328. A table showing the cost breakdown of the early start items separately from the rest of the cost estimate should be attached to the Form HUD-92415 and be made part of the form HUD-92264 Section O, Remarks.
6. Preconstruction conference must be held before the start of any construction (see Chapter 12 Section 12.2).
7. Violations of early start criteria must be referred to the MF Regional Center/Satellite Office Director for a determination as to whether the project may proceed to initial endorsement.

## **5.9 Standard Processing for Substantial Rehabilitation – Concept Meeting through Initial Endorsement**

All of the previous instructions for standard processing of applications for new construction (Sections 5.7 and 5.8 of this Chapter) apply to substantial rehabilitation projects except as modified here.

- A. **Concept Meeting.** The concept meeting is an important opportunity to describe and determine the expected scope of work for existing properties, which may range from significant rehabilitation to more limited repairs and alterations.
  1. A key result of the concept meeting should be consensus on the methods and the professionals that will be used to evaluate the existing buildings and define the scope of work. The lender and Project Architect must describe a process consistent with Appendix 5G and a timeline for evaluating the existing buildings and developing the scope of work and supporting due diligence.
  2. Seismic Threshold for Retrofit Analyses. Appendix 5C defines a step-by-step process for determining whether seismic conditions warrant further analyses of existing buildings in accordance with the most recent standards of the American Society of Civil Engineers (ASCE). The threshold is easily determined, requires no on-site analysis or observation of buildings or sites and should be provided at the concept meeting to indicate whether seismic analyses are required. (The CNA eTool requires a determination of these same threshold values.)

3. Other Due Diligence Studies or Reports. The lender should describe the existing or expected due diligence analyses including lead-based paint inspection for buildings constructed prior to January 1, 1978, buildings with asbestos materials and any other known or reasonably anticipated hazards. See Chapter 9 for other environmental review requirements.

**B. Pre-application.** The lender's exhibits for pre-application are the same as those for new construction with these additional items or considerations:

1. Due Diligence and Draft Scope of Work Summary.

The lender should submit a draft Scope of Work Summary prepared by the Project Architect in developing detailed plans, specifications and cost estimates based on conclusions from the Concept Meeting, the Project Architect's own detailed inspection and due diligence of the property.

- a. The draft Scope of Work Summary should describe the overall anticipated scope of work and identify other due diligence professionals engaged and describe their qualifications.
  - b. The composition of the due diligence team should address the condition of the property and issues foreseeable based on the borrower's objectives and the proposed improvements (scope of work).
  - c. The results of any more advanced due diligence agreed upon at the Concept Meeting (e.g., a joint inspection by the design team) should inform the pre-application.
  - d. The summary descriptions of the proposed improvements should include sketch plans. The final Scope of Work Summary should be submitted at the Firm Commitment Application per Section 5.9.C.3 below.
2. Joint Inspection and Joint Inspection Report.

The purpose and the requirements of the joint inspection are as follows:

- a. To establish a common understanding of the existing physical condition of the property and the necessary improvements to be addressed in the scope of work. All involved parties should agree on the methods and procedures necessary to adequately evaluate the physical needs, such as intrusive testing and various professionals to be employed for further assessments and developing the scope of work.
- b. The lender is responsible for arranging the joint inspection and reporting the findings.
  - i. At a minimum, the borrower, the lender's underwriter or a representative, the lender's Construction Analyst and the Project Architect must attend.
  - ii. HUD staff may attend depending on the availability and the complexity anticipated.

- iii. The local Building Code Official should be encouraged to attend, particularly for the older properties that were built to outdated building code. The official should be asked to provide guidance on any improvements required to meet the current code and safety standards particular to the jurisdiction.
    - iv. Join Inspection Report. The lender is responsible for documenting the inspection with notes, annotated photographs and summary of conclusions in writing and distribute to all involved parties.
  - c. The joint inspection should be scheduled as early as feasible and may follow the concept meeting. If not scheduled prior to the pre-application, it must be scheduled promptly following the pre-application and before the execution of further due diligence or design work.
  - d. Except for LIHTC projects, a decision on any request for streamlined processing should be made only after the joint inspection, or subject to the completion of the joint inspection.

3. Substantial Rehabilitation and Requests for Streamlined Processing.

Given the more contingent and variable circumstances typical of work with existing buildings (by contrast with new construction), any borrower or lender request for streamlined processing for substantial rehabilitation (other than LIHTC projects) must include documentation demonstrating prior experience and capacity in properties of similar scale, condition and building technologies employed. This demonstration should be made for each participant: sponsor, Project Architect and design consultants, Needs Assessor and any due diligence consultants, General Contractor, and the lender's Construction Analyst.

4. Sketch plans of the existing building(s) "as-is" should be provided with the pre-application.
5. The lender should determine the year built for each building and whether each building was built for first occupancy after March 13, 1991, using dates of occupancy permits and building permits when any doubt exists. (If a CNA is prepared as part of due diligence, the CNA eTool will require the Needs Assessor to obtain and supply this information.) If first occupied after March 13, 1991, each such building must conform to the design and construction requirements of the Fair Housing Act (42 USC 3604(f)(3)(C), and 24 CFR 100.205). See Appendix 5B.
6. The lender must determine whether the property is proposed to be or ever has been Federally assisted. The CNA eTool requires this information. If so, the property must conform to the Uniform Federal Accessibility Standards and the requirements of 24 CFR 8.23, 8.26, 8.31, and 8.32. See Appendix 5B.
7. The lender should provide lead-based paint (LBP) test reports for projects constructed prior to January 1, 1978, and asbestos report. Delivery of these due diligence items may be deferred until Firm Application if consistent with and scheduled as part of an agreed work plan for due diligence.
8. See Chapter 9 for environmental review requirements.

C. **Firm Commitment Application.** The lender shall submit final drawings, specifications and costs analyses and unsigned contract agreements similar to applications for new construction except as follows:

1. Form of Drawings and Specifications Matched to Scope of Work.

The borrower's architectural, engineering and cost exhibits for substantial rehabilitation must be based on due diligence studies and examination of existing conditions. Because existing conditions vary widely, the extent and form of drawings and specifications (plans and specs) will also vary. For substantial rehabilitation, plans and specs should be prepared and submitted in the same manner as for new construction.

2. Lender Construction Analyst's Review Reports.

The Construction Analyst should specifically determine whether the scope of work documented in the plans and specs adequately addresses the existing conditions and deficiencies including life safety deficiencies and accessibility violations. All the proposed work must be described adequately with a level of detail that describes measurable quantities, specified quality or performance standards, precise locations of work and is both actionable and amenable to inspection of completed work.

3. Final Scope of Work Summary.<sup>15</sup>

The Construction Analyst must prepare a final Scope of Work Summary that concisely and descriptively itemizes all the improvements that the Project Architect has designed and proposed to do as prescribed in the final plans and specs.

4. Building and Unit Areas and Counts.

Building and unit area and unit count breakdowns by buildings as well as the project totals should be recorded as a schedule (table) of buildings and units in the drawings prepared by the Project Architect in accordance with Appendix 5E. These counts and areas should also be entered in the CNA eTool. An approved CNA prepared in the CNA eTool creates a permanent electronic record of this information and should be inclusive of all the proposed improvements.

5. Operation and Maintenance Plans.

For projects that contain lead-based paint (LBP), asbestos, or have ongoing risks such as radon that may require permanent installation of ventilation, detection or alarm devices, the borrower or Project Architect is responsible for engaging the services of qualified abatement contractor(s) to prepare a scope of work for the abatement or mitigation. Where the scope of abatement work consists of permanent enclosure or encapsulation or ongoing monitoring, but not removal, a qualified consultant or abatement contractor(s) must also prepare, separate from the scope of abatement work, an Operations and Maintenance (O&M) Plan. The O&M Plan must describe ongoing maintenance procedures to be

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<sup>15</sup> Previously referred to as "Detailed Work Write-Up".

followed for as long as the hazard remains in place. All abatement work and ongoing maintenance activities for radon, LBP, asbestos, and/or any other hazards shall conform to the requirements described in Chapter 9. At the time the CNA is submitted in the CNA eTool, any O&M plans should be attached with the submission.

A condition shall be attached to the Firm Commitment requiring that the borrower operate and maintain the property consistent with the referenced O&M plan(s) for the duration of the insured mortgage.

6. Davis-Bacon Wage Standards and the CNA eTool.

For substantial rehabilitation, the future replacement costs of the components and systems estimated in the CNA eTool for the purposes of financial planning are not subject to wage decisions. On the other hand, the summation of costs in the standard trade breakdown in General Contractors estimate (HUD-2328) should be based on the contractor's use of the prevailing wage decision. The lender's Construction Analyst's detailed estimate (HUD-92326) and comparison of estimates (HUD-92331-B), together with the architectural and cost portions of the HUD-92264 signed by the Construction Analyst, should also reflect the use of the prevailing wage decision. These forms should be part of the Construction Analyst's cost analysis report.

7. Project Architect's Certification. For applications proposing substantial rehabilitation, the Project Architect's certification (Appendix 5H.1) should be submitted.

8. The construction documents (plans and specs), Project Architect's certification, due diligence, engineering, and related studies, if any, and the lender Construction Analyst's cost package is submitted in the same manner as for new construction.

9. Consultation with the State Historic Preservation Officer (SHPO) is required as part of HUD's determination of whether the property is a historic property or is in a designated historic district, and whether there will be adverse effects to a historic property. The SHPO consultation must be completed no later than the submission of an application for Firm Commitment. (See Chapter 9).

10. See Chapter 9 for environmental review requirements.

**D. Firm Commitment to Initial Endorsement.**

After Firm Commitment and not later than 30 days prior to the initial endorsement, the lender must assemble the final, printed plans, drawings, specifications, construction schedule, and contract forms. Even if such documents were electronically submitted, they must still be printed, and signed in the requisite number of counterparts as described in Section 5.8 and confirmed as sufficient, authentic and final documents for contract purposes.

## 5.10 Standard Processing for Refinance or Acquisition, Section 223(a)(7) and 223(f) for Repairs and Alterations

The previous instructions in this chapter apply to projects insured pursuant to Section 223(a)(7) and 223(f) for repairs and alterations, except as modified below.

- A. **Architectural Standards.** Eligible properties are existing buildings, and the criteria for acceptance are **not** the same as for proposed construction. See Appendices 5A and 5B for architectural standards for existing buildings.
- B. **Concept Meetings.** Neither concept meetings nor pre-applications are needed for 223(a)(7) applications and are not required for 223(f) applications, and the Firm Commitment applications may be submitted directly to HUD for review.
- a. A concept meeting may be advisable for 223(f) applications with Level 2 and/or Level 3 Alterations that are significant and approach the threshold definition of substantial rehabilitation (See 5.1.B). In that event, the purpose of the concept meeting is to determine the scope of work, or to establish agreed upon due diligence that will develop the scope of work.
  - b. A concept meeting is also advisable for Section 223(f) applications receiving new tax credits.
  - c. Section 223(f) applications with repairs and alterations intended to achieve a green building certification should be presented in a concept meeting, in which event a purpose of the concept meeting is to confirm the appropriate choice of a green building certification and achieve mutual understanding of the requirements for certification.
- C. **Capital Needs Assessment.** Except for properties receiving new tax credits, a CNA based on existing conditions is required for all applications submitted under Section 223(a)(7) and 223(f). The lender must retain a qualified Needs Assessor who must complete the assessment in accordance with Appendix 5G not earlier than 180 days prior to the application for Firm Commitment. The CNA prepared for properties receiving new tax credits should be prepared to describe future replacement needs consistent with the procedure described at Chapter 5.6.B.4.

A previously completed CNA may be accepted if:

1. It is dated not more than two years prior to the date of application for Firm Commitment;
2. The MF Regional Center/Satellite Office Director approves the use of the existing CNA for purposes of the application;
3. The CNA contents and scope conform to the requirements of Appendices 5B and 5G and the CNA is prepared in the CNA eTool; and
4. The mortgagor and lender are required to provide a new CNA not later than 10 years after the date of the CNA accepted with the application.

5. Stale Needs Assessment. If the date of the CNA is more than 180 days from the submission date of an acceptable Firm Commitment application, HUD will return the CNA to the lender and the lender must order an updated CNA. The Needs Assessor must re-inspect the subject property, updating any structure and/or site conditions observed, and submit the new CNA in the CNA eTool.

#### **D. Lender's Review and Reporting of Costs**

1. Lender should ensure that each repair and alteration work items listed in the CNA eTool is identified by Class of Work and properly cross-referenced with any plans and specs, as relevant.
2. When a General Contractor is engaged, the lender should verify that the costs of repairs and alterations as reported in the CNA e-Tool's lists of Critical and Non-Critical repairs are hard costs only<sup>16</sup> and consistent with any bids obtained or if applicable, General Contractor's AIA A104.
3. Report costs (both the hard costs and soft costs) in accordance with Section 5.3.C.5 using the Lender's 223(f) Repairs & Alterations Cost Worksheet (Cost Worksheet) when a Project Architect and/or General Contractor is involved.
4. No totals from the Cost Worksheet should be transferred to the HUD-92264, Section G. However, the lender should ensure that their appraiser is provided with the Cost Worksheet and the lists of repairs and alterations so that the appraisal may establish value based on the assumption that repairs and alterations are completed. If the appraiser concludes that repairs and alterations have a material impact on income (Section C), on amenities and services (Section D), or on expenses (Section E) then these impacts should be reflected in the relevant section and explained in Remarks (Section O). The CNA e-Tool report entitled "Property Insurance Schedule" (the automated HUD form 92329) describes the estimated replacement cost for all improvements assuming the improvements are reconstructed at current construction pricing. This figure should be entered in line 72 of Section G. The appraiser's valuation of the land should be entered in line 73a and the total entered in line 74.
5. Similarly, on the HUD-92013, the description of the property (Section C), available utilities (Section D) income (Section E), equipment and services (Section F) and expense (Section I) should assume the completion of repairs and alterations. In Section G, the sum of hard and soft costs of repairs and alterations should be entered in Section G, line 20. If a refinance, the amount required to pay-off existing liens should be entered in Section G, line 23 and the line item renamed "Existing Debt". If an acquisition, the contract price should be entered in Section G, line 46 and the line item renamed, Purchase Price. These entries plus other costs (MIP, financing fees, due diligence fees, relocation, etc., on lines existing in Section G of the HUD-92013) will be summed in Section J, Line 1.

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<sup>16</sup> Soft costs should not be apportioned to individual repair work items. They are separately recorded. This is because the cost of any component, either installed for the first time or replaced as other than a "One Time Repair," will be scheduled for replacement in the future at the end of its Estimated Useful Life. Adding soft cost to that component perpetuates the one-time soft cost in each future replacement.

6. The referenced HUD forms (92264; 92264A; 92013) are not attachments to the CNA in the CNA e-Tool.
  
- E. **Certification.** By submitting the CNA through the CNA eTool, the lender certifies that it has selected a qualified Needs Assessor with no conflicts of interest in the transaction and has reviewed the assessment for completeness, accuracy, reasonableness and conformance to HUD requirements. (See Appendix 5G for certification language.)
  
- F. **Firm Commitment Application Exhibits.** Required architectural/engineering/cost related exhibits as listed in Appendix 5D.III must be submitted at the time of Firm Commitment Application.
  
- G. **Attachments to Firm Commitments.** For 223(f) applications with no new tax credits, the scope of work for any repairs and alterations may be described by attaching to the Firm Commitment the printed results of the Lender's 223(f) Repairs & Alterations Cost Worksheet along with the printed lists of repairs and alterations from the approved CNA eTool. When a detailed construction schedule is required, it too should be attached. If plans and specifications and AIA contracts exist, they should be referenced but not attached.
  
- H. **ALTA/ASCM Land Title Survey, Form HUD-91073M, Surveyor's Report and Title Report.** For specific survey requirements, see Appendix 5A, Subsection G.
  
- I. **Maximum Time for Completion of Repairs.** Appendix 5G requires that all repairs and alterations be identified as either critical or non-critical. Critical repairs are further identified as either Life Safety or Accessibility. The "Life Safety" repairs address any hazards to life and health, while the "Accessibility" repairs are to correct accessibility deficiencies. While these are not mutually exclusive, only one designation may be applied to each repair or alteration. All other repairs and alterations are non-critical repairs.
  1. Life Safety Critical repairs must be completed prior to Endorsement.
  2. Accessibility Critical repairs must be completed prior to endorsement. When completion prior to endorsement is not possible due to an extensive scope, the repairs must be done as soon as possible within twelve months of closing. The time required to complete each repair must be identified as a number of months, no greater than twelve. The months identified must reasonably demonstrate "as soon as possible" and should be supported with reasons considering the difficulty and the scale of the work, external factors such as the weather, labor market, and logistics such as scheduling.
  3. For any Accessibility repairs that are proposed to exceed twelve months, a corrective action plan must be referred to HUD headquarters to the attention of the Director of Technical

Support in the Office of Multifamily Housing Production, who will determine whether the proposed corrective action plan is acceptable.

4. Non-critical repairs must be scheduled to begin promptly after closing and timely completed within twelve months of the endorsement. The MF Regional Center/Satellite Office Director may approve an extended period not to exceed six additional months for unusual circumstances (e.g., work constrained by weather conditions or work requiring temporary relocation of elderly or disabled tenants). A program of repairs and alterations which because of scale or quantity is reasonably expected to require more than a year to complete should be reconsidered as substantial rehabilitation.

**J. Disruption During Construction.** If proposed repairs or alterations require occupancy or cash flow disruption, the lender should estimate such losses by month and add the aggregate total to an operating deficit escrow, not the repair escrow.

**K. Funding Repairs, Escrow Agreement for Deferred Repairs (Form HUD-92476.1M).** See this Form, Chapter 8 Section 8.11.A.2.d and Chapter 12 Section 12.17.A for greater detail on these provisions.

1. The costs of the deferred repairs (including materials, labor, permits, profits, etc., trended to the start of repairs) must be estimated and withheld in cash from mortgage proceeds and placed in escrow. In this context, deferred repairs include all immediate repairs identified in the CNA that are proposed for completion after endorsement, including both non-critical repairs and any accessibility remedies that cannot be completed prior to endorsement. A letter of credit may not be substituted for this escrow.
2. An additional cash amount (or letter of credit, at the option of the lender) of not less than 20 percent of the repair cost estimate will also be placed in escrow as an assurance of completion of deferred repairs, provided however, that;
  - a. For 223(a)(7) transactions and 223(f) for affordable properties, the additional amount shall be 10% of the repair cost; and,
  - b. For 223(f) applications, the additional deposit may be reduced to 10% of the cost for any repairs and alterations where:
    - i. a design professional has prepared construction drawings, and the borrower has engaged a non-identity of interest General Contractor to execute the work; and
    - ii. the contract provides for the withholding of retainage in the amount of 10% of the value of work completed.
3. The lender may release funds from the mortgage proceeds portion of the escrow in proportion to the cost of work completed consistent with HUD's instructions for disbursements from repair escrows. See Chapter 12 Section 17.
4. Funds remaining in the escrow may be released to the borrower when:

- a. All repairs have been satisfactorily completed as determined by HUD or lender when delegated to an approved lender;
  - b. Evidence of clear title has been provided to HUD; and,
  - c. In cases where the cost of repairs and alterations included in the Repairs Escrow exceeds \$400,000, the borrower (or the General Contractor in cases where a construction contract was executed) has provided latent defects assurance in the form of an escrow in cash or letter of credit or surety bond (at the option of the lender) equal to 2½% (or a greater percentage as warranted) of the repair cost, to be maintained for fifteen months from completion of repairs. See paragraphs 8 and 9 of HUD-92476.1M for further details.
5. Except in the case of existing insured projects, where the current balance in the Reserve for Replacement escrow may exceed the initial deposit otherwise required to provide a balanced financial plan for future capital replacement needs, funds deposited in the Reserve for Replacement escrow account at or after endorsement shall not be used for the completion of any immediate repairs and alterations.

**L. Withholding of Excess Proceeds.** In cases where completion of repairs is deferred and the mortgage amount exceeds the costs of refinancing and all required costs, including repairs (“cash-out transactions”), the lender shall withhold 50% of the excess proceeds until all repairs and alterations are completed in a manner acceptable to the lender and HUD. The withheld funds will be added to the repair escrow. (See Chapter 8 for detailed escrow release instructions).

**M. Completion of Repairs and Alterations.**

1. If the borrower has not completed all the required scope of work by the repair schedule set in the Escrow Agreement or including any HUD-approved extensions, the lender shall complete the work using the remaining escrowed funds and the assurance of completion escrowed funds. The lender will provide HUD a new repair schedule. In addition, the lender will provide the borrower with a breakdown of these repairs and the cost(s) of completion (including administrative expenses). Funds remaining in the escrow account after completion of the repair work will be returned to the borrower less reasonable administrative costs incurred in completing the repairs.
2. Requirements after Completion of Repairs. In cases where all or a portion of the costs of repairs and alterations support the size of the loan amount and actual costs are less than estimated, the maximum insurable loan amount must be recalculated and this recalculated figure compared to the endorsed loan amount. When the recalculated maximum insurable loan amount is less than the endorsed amount, the borrower must use the excess proceeds for one or more of the following purposes:
  - a. Additional repairs approved by HUD and the lender; and/or

- b. Prepayment of the mortgage in amounts equal to the scheduled monthly principal payments, with any remainder going to the Reserve for Replacements.

## **5.11 Standard Processing for Section 241(a) Supplemental Loan**

### **A. Section 241(a) Supplemental Loan for New Construction.**

1. Chapter 5.3 Section B requirements and instructions apply to 241(a) applications involving new construction, except as modified below:

A CNA of the existing improvements at the property is required to identify deficiencies and repair needs as may exist in the existing improvements which repairs, and alterations must be included in the proposed scope of work. However, a single CNA eTool for the entire property must produce one reserve for replacement schedule of all the components, inclusive of future replacements at the existing improvements as well as for any proposed new structures and additions.

2. Processing requirements for new construction as described in Chapter 5.7 and 5.8 apply.

### **B. Section 241(a) Supplemental Loan for Existing Structures Only.**

1. Substantial Rehabilitation. 241(a) applications involving substantial rehabilitation as defined in Chapter 5.1.B are required to meet the following:
  - a. For the buildings and other structures undergoing substantial rehabilitation at the property, the requirements in Chapter 5.3.B apply regarding required professional services, documentation and oversight.
  - b. Processing requirements for substantial rehabilitation as described in Chapter 5.7, 5.8 and 5.9 apply.
  - c. When certain existing buildings and improvements are not included in the substantial rehabilitation scope of work, a CNA for those existing structures is required. Any identified deficiencies and immediate repair needs must be included in the plans and specs produced by the Project Architect for the substantial rehabilitation work.
  - d. The structures to be built or substantially rehabilitated are included the CNA based only on future needs planning, derived from plans and specs.
  - e. The Section 241(a) loan combined with the original first mortgage shall be considered one project and the CNA must produce one Reserve for Replacement schedule and budget inclusive of the existing improvements as well as the proposed improvements.

2. 241(a) applications involving repairs and alterations.

241(a) applications with a scope of work less than substantial rehabilitation must follow the requirements described in Chapter 5.3.C and the following:

- a. The CNA should identify and categorize repair needs in the same manner as 223(f) applications.
- b. The identified repairs must be remedied in the proposed scope of work in the 241(a) application and the cost of such repairs may be included in the 241(a) loan amount.
- c. The Section 241(a) loan combined with the original first mortgage shall be considered one project and the CNA must produce one Reserve for Replacement schedule and budget inclusive of the existing improvements as well as the proposed improvements.
- d. Processing requirements for Section 223(f) as described in Chapter 5.10 apply.

## 5.12 Cost Estimating for Lenders

Evaluating the estimates of construction cost prepared by the borrower, Project Architect, General Contractor, Needs Assessor and/or Construction Analyst is a critical element of the lender's underwriting task. It is the lender's responsibility to ensure that the borrower and third-party professionals have developed and described costs in accordance with Chapter 5. For new construction and substantial rehabilitation projects under Sections 220 and 221(d)(4) and 241(a) supplemental loans, replacement cost is one of the criteria used to determine the insured mortgage amount. In value-based programs, Section 231 and Section 223(f), replacement cost is a significant consideration in valuation, (except for properties 10 or more years old). Cost estimating consists of estimates of the construction costs for proposed improvements and/or repair and alteration costs for existing improvements.

### A. Method of Estimation.

1. New Construction and Substantial Rehabilitation. The method should be similar to that used by General Contractors. For new construction and substantial rehabilitation, data should be organized by trade division using the Construction Specification Institute (CSI) Format,<sup>17</sup> then adjusted to reflect cost differences due to time, location, and price fluctuations. The cost estimate may be prepared using a quantity takeoff or a square-foot and per-unit cost approach using established data and making adjustments. The lender's Construction Analyst must develop HUD-92326 cost estimates independently and compare with the General Contractor's HUD-2328 costs using the HUD-92331-B form.

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<sup>17</sup> HUD forms reflect the sixteen-division CSI format (pre-2004).

2. Repairs and Alterations Less than Substantial Rehabilitation. Needs assessors and lender Construction Analysts should develop and document costs in the CNA eTool, estimating costs for each repair item and component replaced or added new.
3. Replacement Cost and Insurable Values. For casualty insurance purposes insurable values by building must be estimated assuming the task of reconstructing the building if it is destroyed, i.e. for the cost of replacing the building as if new (not restoring the structure as it was originally built using obsolete methods and materials.) Accordingly, for all existing structures replacement cost as if new (notwithstanding its condition) should be estimated for each building on a “per square foot” basis. This figure should be entered in the CNA eTool on the Buildings Form. For new construction, estimated costs are “as if new” and so total estimated costs of buildings, (not site improvements) including soft costs and fees should be converted to a “per square foot” figure for each building and entered in the CNA on the Buildings Form. (See Appendix 5G, Section V).

**B. Data.** The data source(s) used to prepare cost estimates must be documented. Acceptable cost data may come from completed comparable projects, benchmark amounts taken from actual project costs, and published data from construction cost data publishers. The CNA eTool requires that replacement cost estimates briefly describe data sources/methods.

**C. Detailed Cost Estimates.** The lender’s Construction Analyst should use detailed plans and specifications supplied by the Project Architect as a basis for the cost estimate. Estimates must reflect the general level of construction costs in the locality where construction takes place. Costs must be projected to the midpoint of the estimated construction period. Davis-Bacon labor wage rates must be used for new construction and substantial rehabilitation. It is the lender’s responsibility to obtain current Davis-Bacon wage rates from HUD and to ensure that the project design team and General Contractor are provided with the relevant and most recent, applicable wage decisions. For new construction and substantial rehabilitation, the cost estimate is tabulated on Form HUD-92326, and totals are reported in Sections G, M, and O of Form HUD-92264.

**D. Categories of Cost.**

The cost estimate consists of the following items:

1. Structures and Land Improvements include:
  - a. Dwelling structures. Costs of all residential buildings including footings and foundations.
  - b. Garages include all covered parking, from individual carports to complete parking structures. For new construction and substantial rehabilitation, include free-standing garage structures with other accessory buildings on the Accessory Structures line on Form HUD-92326. Garages are reported separately in Line G.39 on Form HUD-92264 except when the garage space is an integral portion of a larger structure; in which case individual trade costs should be reported for the entire

structure and not separately for the parking element. Similarly, costs should not be separated when accessory uses or commercial space is included as part of a larger dwelling structure.

- c. Parking and the CNA eTool. Surface parking, including carports, are treated as site improvements in the CNA eTool. In a building designed exclusively for parking (or if parking is a use of space in a larger building with other uses), all enclosed (garage) parking is treated as a common space even if spaces can be or are assigned to particular tenants or units. In some building configurations (e.g., attached townhouses) garages may be part of a dwelling unit and available only to a resident of that unit. Such garages are called “in unit” garages and the square foot area of such “in unit” garages is included in the area of the unit. “In unit” garages are not common space. Replacement cost is estimated for each building including all the uses of space in the building.
- d. Onsite land improvements make up the following trade line items on Form HUD-92326: Earthwork, Site Utilities, Roads and Walks, Site Improvements, Lawns and Planting, and Unusual Site Conditions. In the CNA eTool onsite land improvements are identified as the need category “site systems.”
- e. In new construction and sometimes in substantial rehabilitation, unusual land improvements may be required to address conditions not typical to most construction in the locality (e.g., excessive excavation, rock excavation, cuts and fills, special foundations, high water table, problem soils, environmental remediation work or installations). These items are taken from the Unusual Site Conditions trade line item on Form HUD-92326 and are reported separately in Line G.36a of Form HUD-92264. They must be itemized separately because of their possible impact on site value. The lender’s Construction Analyst should consult with the lender’s underwriter and appraiser to define and quantify the need for unusual land or site improvements.
- f. Short extensions or connections of roads, walks, and utilities from project site boundaries to adjacent offsite public improvements are considered onsite land improvements.

2. Supplemental Cost Estimates include:

- a. Demolition. Demolition is defined as onsite work to remove the existing structure, footings, foundations, and utilities to prepare a site for new construction.
  - i. Include the removal and disposal of debris and fill and compaction of excavations. Include General Contractors' and subcontractor’s overhead and profit in the estimate.
  - ii. Report on Form HUD-92326, under “demolition,” and Form HUD-92264, Section O. Appraiser will report Demolition costs in Section J of Form HUD-92264.
  - iii. Demolition should not be included in the construction contract.

- iv. “Demolition” in this context does not include interior demolition within existing structures undergoing substantial rehabilitation.
    - b. Offsite work is work not adjacent to project boundaries including utilities, walks, curbs, gutters, streets, drainage structures, landscaping, etc., that extend away from the project site. These improvements are not included in the construction contract. Report on Form HUD-92326 and Section M of Form HUD-92264.
3. Cost Not Attributable to Dwelling Use. Cost Not Attributable is the construction cost estimate of certain project amenities not directly used for residential dwelling and is calculated only for properties where Criteria 4 is the determining criterion. This cost is calculated by the cost analyst and used by the appraiser to increase the maximum mortgage amount under Criterion 4 of Form HUD-92264-A (Statutory maximum insurable mortgage amount per dwelling unit). Criteria 4 is typically not material in determining the maximum insurable mortgage, and the calculation is material only when project costs are likely to exceed the statutory limit and when a portion of those costs are not attributable to dwelling units.
  - a. Cost Not Attributable must be included within the estimate of total structures and land improvements, and the costs must be itemized and reported separately on Form HUD-92326 and Section M of Form HUD-92264. The reason to estimate cost-not-attributable is to isolate construction costs for (A) all improvements and for (B) selected improvements not related to or necessary for the dwellings (non-residential use). In each case the total is without general requirements and fees.
  - b. The percentage of (B) divided by (A) is the percentage of costs not attributable. Such a percentage should be calculated for both residential buildings/spaces and commercial buildings/spaces in the project, and neither number may exceed a fixed maximum of 15%. The two are added together to obtain the project percentage of cost-not-attributable.
  - c. This figure is used to allocate a proportionate share of all other mortgageable costs (fees, construction period interest and finance charges, etc.) between dwelling use and costs not attributable to dwelling use. The total of all Costs Not Attributable times the maximum percentage loan-to-cost ratio is added to the maximum statutory limit calculated for the number of units by type. The sum is the maximum mortgage amount per Criteria 4. (See Appendix 5J).
4. Cost Not Attributable for Section 223(f) Statutory Limit Constrained deals. Costs Not Attributable to dwelling use may be used to adjust the statutory limits (Criteria 4 of the form HUD-92264A) for all Section 223(f) insured loans applications. See Appendix 5K for calculating Cost Not Attributable for 223(f)s.
5. Allowances and Fees. Allowances and fees are reported on Forms HUD-92326 and HUD-92264 as lump-sum dollar amounts but should be supported with itemized cost schedules attached to these forms

- a. General Requirements (Job Overhead). Covers project-specific overhead and construction staging expenses.
  - i. Include:
    - (a) Supervision and job-site engineering;
    - (b) On-site job office expenses directly related to the project including clerical wages;
    - (c) Temporary buildings, tool sheds, shops, and toilets,
    - (d) Temporary heat, water, light and power for construction;
    - (e) Temporary walkways, fences, roads, siding and docking facilities, sidewalk and street rental;
    - (f) Construction equipment rental not included in trade item costs;
    - (g) Cleanup and disposal of construction debris not included in trade or sub-contract costs;
    - (h) Medical and first aid supplies and temporary facilities;
    - (i) Security guard wages and related costs;
    - (j) Theft and vandalism insurance. (does not include Builders Risk Insurance);
    - (k) Builders Risk Insurance. Builders Risk Insurance is separate from any theft and vandalism insurance policy provided by the General Contractor. While Builders Risk Insurance may be placed by either the General Contractor or the Borrower, it is common industry practice for the contractor to place the policy, with the contractor named as Insured, and the Borrower named as “Other Insured.” Regardless of which party is responsible for payment, the Borrower must always be named as an Insured party, as per Builder’s Risk Insurance requirements in Form HUD-92447, Property Insurance Requirements.

When the contractor pays for the policy, the premium may be included in the General Requirements or the contractor’s Other Fees. When the Borrower pays for the policy, the insurance premium is included under Insurance on Line G-55, Insurance, of Form HUD-92264.
  - ii. Salaries for site visits by owners, partners, or officers of the general contracting firm are included in General Overhead, except for payment for

work done on the job by these individuals in a trade capacity, as laborers or supervisors.

- b. General Overhead. Covers contractor's home office or principal office and general business expenses. The amount is fixed at up to two percent of the sum of Total Land Improvements, Total Structures, and General Requirements.
- c. Builder's Profit or Fee. Builder's Profit or Fee is calculated as a percentage of the sum of Total Land Improvements, Total Structures, and General Requirements. The percentage amount is determined by the nature and location of the project and market conditions and should be compared to the amount of the fee negotiated between the borrower and contractor for reasonableness. When the General Contractor is an independent third party (no identity of interest with the borrower or sponsor) the Builder's Profit or Fee is an actual cost that must be paid to the General Contractor. This applies to all non-identity of interest General Contractors participating in any of HUD's mortgage insurance programs. When the General Contractor has an identity of interest with the borrower, see paragraphs "d" and "e" below.
- d. Development fees in Value Based Programs - Section 231 Substantial Rehabilitation and 223(f). Except for certain affordable housing transactions, development fees payable to affiliates of the borrower (i.e., identity of interest participants) are not mortgageable costs and should not be included in the cost estimate. A reasonable and customary general contractor fees and costs payable to unaffiliated third parties are eligible. (See Appendix 3B for treatment of fees in certain affordable housing transactions.).
- e. BSPRA. Builder's and Sponsor's Profit and Risk Allowance (BSPRA) is a presumed profit for development and construction of a multifamily project. It is unique to applications for new construction or substantial rehabilitation under HUD's "cost-based" programs (Sections 220 and 221(d)(4)) when an identity of interest exists between the borrower and the General Contractor. BSPRA is always 10% of replacement cost not including land but is itself not an actual cost or fee to be paid to the identity of interest General Contractor and/or development entity (sponsor). It is used to calculate the mortgage amount in Criterion 3 on the HUD 92264-A. Its effect is to allow the identity of interest borrower/developer/contractor to contribute its presumed builder/developer profit (BSPRA) as equity whenever the mortgage amount is limited by Criteria 3. In a balanced summation of sources (loan proceeds, equity, etc.) and uses (costs of land, development, construction, capitalized interest, etc.) this imputed profit or BSPRA is added both to uses and sources. When Criterion 3 prevails, the mortgage amount will be a fixed percentage of costs. The "B" in BSPRA refers to the presumed fee of the builder or General Contractor. The "S" refers to development cost of the sponsor/borrower outside the general contract and is called SPRA. The appraiser calculates the BSPRA amount and enters it in line G 68 of Form HUD-92264. When BSPRA is used, the lender should:
  - i. Calculate an equivalent builder's profit (the "B" portion of BSPRA) and an equivalent subtotal.

- ii. On the Builder's Profit line of Form HUD-92326 and in Line G 44 of Form HUD-92264, enter the word "BSPRA". The equivalent builder's profit calculated above is not included in the Total for All Improvements (bottom of Form HUD-92326 and Line G.50 of Form HUD-92264).

Use of BSPRA is not mandatory. A borrower may pay an affiliated General Contractor an actual builder's fee or profit provided that the amount of the fee is reasonable and customary; the form of the construction contract is cost plus fixed fee; the mortgagor and General Contractor cost certify; and, the amount of the fee is funded in the construction escrow established at initial endorsement.

- f. Architect's Fees. The source of this cost is the Owner-Architect Agreement, (see Section 5.3.D). If there are multiple prime agreements (e.g., separate Design architect and Supervisory architect), total all fees in line G 45 of HUD-92264 and itemize in Section O, Remarks. The lender's Construction Analyst should copy the fee amounts, unaltered, to the cost estimate. The Construction Analyst should document architect's fees and compare with existing fee data to determine reasonableness. The Construction Analyst should inform the lender's underwriter if fees are significantly different from the data range, but the fees should not be altered on the cost estimate without a prior meeting between the lender, lender's Construction Analyst, borrower, and Project Architect.

For new construction and substantial rehabilitation applications, fees should be documented as a percentage of the sum of Total Land Improvements, Total Structures, General Requirements, General Overhead, and Builder's Profit. The Architect's Fee usually consists of a design fee to cover the cost of the preparation of all construction documents (working drawings and specifications) up to start of construction; it typically represents 75 to 80 percent of the total fee. The Architectural Supervision fee covers the cost of the Project Architect's construction inspections, reports, and preparation of change order requests; it typically represents 20 to 25% of the total fee.

- g. Bond Premium. Covers the cost of Payment/Performance Bonds used to ensure completion of construction in event of a default by the General Contractor. The bonding or surety company determines the premium or cost based on its perception of risk in light of the contractor's financial capacity and performance history and the nature of the work. Letter of Credit Fee can be mortgaged if the developer is using a letter of credit for assurance of completion instead of bond.
- h. Other Fees. Costs of various required items and services can vary greatly among jurisdictions and localities. Other Fees can be paid either by the borrower or the General Contractor. The borrower should submit an itemized list of all project-related Other Fees as an aid to the Construction Analyst. Other Fees paid by the General Contractor should be entered in form HUD-2328. Owner's Other Fees entered into form HUD-92264 Section G include the General Contractor's Other Fees amounts. Other Fees include:
  - i. Site and topographic surveys;

- ii. Subsurface exploration (test borings);
  - iii. Soil tests, concrete tests, and other construction testing;
  - iv. Fees for utility taps and connections;
  - v. Impact fees for public infrastructure;
  - vi. Building permits and licenses; and
  - vii. General Contractor's cost certification audit fee (if required). NOTE: The borrower's cost certification audit fee is not to be included in Other Fees since it is recorded separately in Line G. 66 of Form HUD-92264.
  - viii. Builders Risk Insurance may be included with general Requirements or Contractor's other fees (only if paid for by General Contractor).
  - i. Furniture, Fixtures, and Equipment (FF&E) includes substantial indoor and outdoor furniture and equipment (e.g., trash dumpsters, pool or recreational equipment, permanent lobby or reception area furnishings, golf carts). It may not include titled vehicles, minor items of relatively insignificant cost such as furniture accessories, rental unit furnishings, hand tools, and hand power tools, or expendable items. An itemized schedule of FF&E with cost for each item will be submitted with the cost documents and reviewed by the lender's Construction Analyst for acceptability. Costs may include only delivery and placement of the item. The dollar amount of FF&E will be reported in line G.60 of the HUD-92264; "AMPO percent (nonprofit only)" will be lined out and substituted with "FF&E".
6. For substantial rehabilitation and new construction, report the construction time in months in Line G.52 of form HUD-92264. This figure will be used to estimate the amount of capitalized interest and carrying costs during the construction period.
- E. CNAs are required for all applications. For new construction and substantial rehabilitation, the lender's Construction Analyst may prepare the CNA based on the Project Architect's proposed plans and specifications assuming construction completion (that is, the CNA will estimate only future repairs and replacements and not immediate construction). In other applications, the CNA is prepared by the Needs Assessor based on existing conditions. In either instance it is the lender's responsibility to ensure that the estimated remaining useful life of components and the costs of future replacements and any immediate repairs are estimated consistent with Chapter 5 and its appendices. The lender's underwriter will develop a financial plan for funding future capital needs by using the "Financial Factors form" (See Appendix 5G). Based on the financial factors, the CNA eTool will generate a schedule of annual deposits to the Reserve for Replacement (RfR) escrow. In accordance with Appendix 5G, the lender must adjust the financial factors so as to plan funding sufficient to pay estimated future capital needs. The borrower's schedule of deposits to the RFR will be based on actual expected capital needs, not on a percentage of construction cost or mortgage amount.
- F. Whether prepared based on conditions at an existing property or for a property to be built, the CNA eTool will generate an estimated replacement cost for each structure, which should be

used as the Schedule of Insurable Values, (HUD form 92329). In the case of CNAs based on construction to be completed, the lender's Construction Analyst should ensure that the replacement cost per square foot entered on the "Buildings form" of the CNA eTool is consistent with cost estimates for each identified building.

### **5.13 Cost Package for Firm Commitment**

As part of the Firm Commitment application, the lender's Construction Analyst will prepare a detailed cost estimate and all required reports and recommendations as described below. For streamlined processing, these same documents will be prepared in draft consistent with the draft drawings and specifications. However, these documents must be corrected as needed and submitted in final form based on the final drawings and specifications no later than 30 days prior to Initial Endorsement.

#### **A. Required Forms.**

1. Form HUD-92326. Used for preparation of detailed construction cost estimate for new construction and substantial rehabilitation projects.
2. Form HUD-92331-B. Used to make a detailed comparison of trade line items between Estimators' cost estimate (HUD-92326) and Contractor's trade payment breakdown (HUD-2328) for new construction and substantial rehabilitation projects.
3. Form HUD-92329. Property Insurance Schedule, prepared in the CNA eTool, used to determine the Insurable Value for each project structure and the aggregate sum for all structures for all applications. Form HUD-92447, Property Insurance Requirements, will be prepared by HUD and provided to the lender at closing.
4. Form HUD-92264. Project Income Analysis and Appraisal.
  - a. Section G. Estimated Replacement Cost, Line 36a through 52 is used to summarize Total Structures, Land Improvements, General Requirements, and Fees from Form HUD-92326, and also records estimated construction time. This section is primarily used for substantial rehabilitation and new construction.
  - b. Section M. Used to summarize Cost Not Attributable to Dwelling Use (lines 10 through 15), and Offsite Requirements (lines 16 and 17).
  - c. Section O, Remarks. Used to explain Unusual Land Improvements, Other Fees, itemization of professional fees (e.g., engineers), the overall difference between lender's and borrower's cost estimates, and other cost items.

B. For new construction and substantial rehabilitation proposals, prepare detailed cost estimate on Form HUD-92326 using instructions in Section 5.11; sign form on the "Estimate Prepared by" line and certify. Refer to standard certification in Chapter 11, Section 11.2.

C. Resolve differences in lender's and contractor's construction cost estimates.

Before the Firm Commitment application can be submitted for HUD review, the construction cost estimates prepared by the General Contractor and the lender's Construction Analyst must be reconciled. The lender's analyst is responsible for resolving major differences between the two estimates. When the two estimates are generally consistent, the lender may use the contractor's cost figures as shown on Form HUD-2328 as its cost estimate. The lender's Construction Analyst will use the following review procedure for new construction and substantial rehabilitation applications:

1. Prepare trade line-item comparison of lender's and contractor's cost estimates using Form HUD-92331-B.
  - a. Enter costs from Forms HUD-92326 and HUD-2328. For multiple-structure type projects, a separate HUD-2328 must be submitted for each structure type, and a master HUD-2328 for the entire project.
  - b. Calculate and list line item percentage differences.
2. Review trade line item differences and note all variations beyond normal ranges. The range of trade line item differences varies from trade to trade. Major trades (e.g., engineers, carpentry) should have a smaller range difference than minor trades (e.g., sheet metal). The analyst should judge the variations based on established data.

Front-end Loading: The analyst should be alert for a pattern of front-end loading in trade items, where the contractor inflates costs for trade items needed early in the job schedule in order to secure more mortgage proceeds early. Such a pattern may indicate inadequate working capital or risky business practices by the contractor. Advances of funds from loan proceeds should always accurately reflect the cost of work completed, and payment should follow, never precede, the completion of work or portions thereof for which payment is requested.

3. Meet with the contractor to discuss and resolve all questionable trade line item differences. The resolution process may result in either the estimator or the contractor, or both, recalculating costs of various trade line items based on discussions.
  - a. If differences are resolved, accept costs in Form HUD-2328 and use as lender's Cost Estimate in Form HUD-92264.
  - b. When dealing with suspected front-end loading, require rigorous documentation of early trade items that are higher than normal.
  - c. If differences cannot be resolved, do not accept costs in Form HUD-2328.
    - i. Use the Construction Analyst's cost estimate as to the lender's cost estimate.
    - ii. Inform the lender's underwriter that the contractor's HUD-2328 is unacceptable.
    - iii. Advise the lender's underwriter to meet with the borrower and the contractor for further attempts at resolution.

- D. Prepare cost portions of Form HUD-92264, using instructions in Section 5.12. Sign the form in the “Cost Processor” box and certify (see standard certification in Chapter 11, Section 11.2).
- E. Property insurance schedule, Form HUD-92329, based on CNA eTool replacement cost per building. Common equipment that serves the entire property or portions thereof (e.g., a boiler and cooling tower assembly) should be included with the cost of the building where it is located and not prorated among the buildings served by the equipment.
- F. Prior approval of identity-of-interest subcontractors’ proposed costs including overhead and profit is required.
  - 1. Identity of interest is a relationship that exists giving the borrower or General Contractor apparent control or influence over a subcontractor, equipment lessor, material supplier, or manufacturer of industrialized housing. (See General Contractor’s cost certification instructions in Chapter 13 - Cost Certification, for definition of relationships).
  - 2. Requirements. When subcontractors, material suppliers, or equipment lessors have an identity of interest with a borrower or General Contractor, the lender must approve the subcontract amounts, including specific amounts for subcontractor general overhead and profit.
  - 3. Timing. Approval is required before work begins under the subcontract. Failure to secure prior approval will result in the disallowance of the total general overhead and profit of the subcontractor at cost certification.
  - 4. Request for approval (with the subcontracts, agreements, or leases) is submitted to the lender’s Construction Analyst, whose recommendations must include:
    - a. Acceptability of the documents.
    - b. Reasonableness of guaranteed maximum prices for the subcontract work.
    - c. Appropriateness of general overhead and profit dollar amounts.
  - 5. Mandatory Conditions for Approval.
    - a. Subcontracts:
      - i. Must be a separate subcontract for each trade.
      - ii. Must clearly identify the scope of work.
      - iii. Must be on a cost-plus fixed fee basis:
        - (a) Guaranteed maximum dollar amount for work.
        - (b) Specific dollar amount for general overhead and profit.
      - iv. Disapprove “paper conduit” arrangements where work is to be done by General Contractor personnel or other subcontractors, suppliers or lessors.

- b. Subcontract prices: For this criterion, recent reliable data is a better test than whether higher bids were submitted.
  - i. The total price must not exceed the amount shown for the trade item on the accepted Form HUD-2328.
  - ii. Total price must not exceed reasonable prices taken from available data.

NOTE: The lender's cost analyst must resolve disagreements in trade prices with the subcontractor.

- c. Overhead and Profit. The amounts for general overhead and profit shall be no higher than the typical prices for the specific trade.
  - d. Subcontractor entity. The burden of proof of 1, 2, and 3 below is on the subcontractor.
    - i. The firm must operate and have documented the experience as a subcontractor for the specific field covered in the subcontract.
    - ii. Must control labor, materials, and equipment typical for the trade.
    - iii. Must do significant business in its specific field with borrowers and General Contractors having no identity of interest.
6. If a total of all identity of interest subcontracts, purchases and leases are less than ½ of 1 percent of the mortgage amount, the requirements for each identity of interest subcontractor to cost certify may be waived by the MF Regional Center/Satellite office Director upon notification by the lender.
7. Prepare a letter of approval or disapproval to the borrower or General Contractor. The letter must address all mandatory conditions.
- a. Approval will indicate any conditions, including whether or not subcontractor must cost certify.
  - b. Disapproval will state the reason for disapproval and indicate any cost certification requirements.

G. Cost Concerns for Substantial Rehabilitation.

The detailed cost estimate should include and evaluate the following:

- 1. Interior demolition and removal of floors, walls, roofs, doors and windows, finishes, cabinets, appliances, plumbing, HVAC, and electrical, including boilers and central air conditioning. Also includes abatement of asbestos and lead-based paint. Enter the amount in Special Construction trade line in Form HUD-92326. If individual trades include removal (e.g., remove and replace cabinets), removal costs may be included in the trade line item.
- 2. Site preparation demolition is not part of the Construction Contract and should be estimated and recorded in the same way as for new construction.

3. Allowances and Fees for substantial rehabilitation, especially General Requirements and Architect's Fees, are calculated the same way as for new construction, but they should reflect the risk and responsibility inherent in rehabilitation and consider the location of the project. It is recommended that the Construction Analyst keep separate data for this item.
4. Rehabilitation time is determined the same way as construction time for new construction, but the data used must take into account the time required for interior demolition, as repair and rehabilitation cannot begin until such demolition is complete.
5. Rehabilitation Cost Not Attributable to dwelling use includes an "as-is" value for non-attributable items in addition to a value for actual work performed. Calculate by using the format in Appendix 5J.2. The Construction Analyst completes steps 1, 2, and 3; steps 4 through 8 are completed by the appraiser.
6. The contingency reserve amount is based on available data for the type and condition of structure. Calculate as percentage of the sum of structures, land improvements, and general requirements. Percentage ranges from 10 to 15%, depending on the condition of the project, extent of rehabilitation, and experience and financial capacity of the borrower and contractor. Enter amount in line G.71 and in Section O of Form HUD-92264. Subject to lender and HUD approval, the Borrower may elect to apply any funds remaining in the substantial rehabilitation construction contingency account after completion of the approved rehabilitation, to:
  - a. further improvements, betterments or upgrades to the property,
  - b. an initial deposit to the Reserve for Replacement account; or
  - c. reducing the mortgage balance.

If excess funds from contingency are used for betterments, those additional improvements will not be considered as the basis for a request for an increased mortgage amount.

#### H. Cost Concerns for Refinance/Acquisition-Section 223(f) and 223(a)(7).

1. The lenders must determine that:
  - a. The CNA describes, quantifies and estimates immediate repairs and future needs consistent with Chapter 5 and Appendix 5G and that replacement costs data sources are identified;
  - b. The assessed remaining useful lives of components and estimated useful lives for alternatives are justified whenever the entered values depart from the Standard Estimated Useful Life Table;
  - c. The flags obtained from validation of the needs assessment via the Validation Engine of the CNA eTool are either removed by amending the needs assessment or explained in a flagged comment.
2. The cost portions of HUD 92264 should be completed based on the replacement cost of buildings as reported in the CNA eTool.

3. The lender must review the Needs Assessor's "Repair, Replace Add New Recommendations" and determine that life safety and accessibility repairs have been identified with a "yes" in the appropriate indicator and that the recommended timing, cost, and other action are appropriate and consistent with observed conditions.
4. The lenders should review any immediate repairs for 223(a)(7) applications to ensure that repairs are limited and do not exceed routine maintenance, except for needed remedies for accessibility deficiencies.

## 5.14 HUD Procedures

All applications will be assigned to a Senior Underwriter or underwriting team by the Production Chief. The underwriting team will complete an early warning system (EWS) review of each application and identify which applications can be assigned to and reviewed by a single underwriter and which may require the assistance of the Technical Branch Chief and/or a HUD Construction Analyst (architect, cost analyst). In general, all new construction and substantial rehabilitation applications should be reviewed by a Construction Analyst. In addition, refinance and acquisition applications with combinations of repairs and alterations exceeding \$15,000 per unit in cost and/or including Level 2 and Level 3 alterations should be reviewed by a HUD Construction Analyst. Applications for Section 223(f) for properties less than 10 years old and for Section 223(a)(7) should not require the assistance of a Construction Analyst unless the CNA contains a corrective action plan for accessibility deficiencies, or the HUD underwriter observes that such a plan is required but not submitted. Section 223(f) applications for properties older than 10 years with repairs and Level 1 Alterations will require the underwriter to determine whether any issues are observed that might require a technical review.

- A. When engaged to complete a technical review or consider a particular lender exhibit, the HUD Construction Analyst should not redo or correct the lender's work. Instead, the review should be summarized in writing for the HUD underwriter.
  1. Review the lender deliverables for completeness;
  2. Examine the review report and the A/E and cost exhibits and recommend either acceptance, acceptance assuming specified modifications or rejection of the A/E and cost portion of the Firm Commitment submission; report to the underwriter on the form(s) at Appendix 5F and following as appropriate for the application stage and program.
- B. Any application for an existing property proposing repairs and alterations in any combination that results in uncertainty about program eligibility (refinance/acquisition vs. substantial

rehabilitation) should be reviewed by the HUD Construction Analyst, who shall review the immediate repairs identified in the CNA eTool.

The costs of all repairs should be totaled and compared to the cost per unit threshold (5.1.D) adjusted for the applicable Hight Cost Percentage. If the total cost of immediate repairs exceeds the threshold, the application must be for substantial rehabilitation.

### C. CNA eTool and the Single Underwriter Way of Work.

The Reviewer Tool web-application of the CNA eTool is available only to authorized HUD (and USDA) staff. Use of the Reviewer Tool is to be consistent with the single underwriter approach and requires that completed work be presented to senior managers before a CNA is approved as part of an underwriting decision on an application for mortgage insurance. Each user will be assigned at least one of three possible roles:

1. **Assigner.** Assigners generally will include the Production Chief, and Branch Chiefs and may include Senior Underwriters. Assigners should have dual roles, i.e., Assigners typically will also have a reviewer role. Assigners receive compiled reports on all CNAs submitted to HUD including information on the program for which application is made or the purpose of the CNA, the name and location of the subject property and the status of the CNA (submitted, under review, ready for decision, returned and approved.). Assigners will also receive a compiled workload report indicating the number of CNAs assigned to each reviewer and certain information useful to assess relative workloads. Using these reports, Assigners will assign submitted CNAs to staff for review. Assigners also have the responsibility to open CNAs made “ready for decision” by their staff, and to modify or edit the reviewer’s comments. If an Assigner desires a Reviewer to modify comments or reconsider issues or seeks additional review from technical staff, the Assigner identifies the Reviewer and reassigns the CNA to that Reviewer. When satisfied that the review is complete and that comments or identified issues require a lender response, the Assigner or the Reviewer may “return” the CNA to the lender. When the lender addresses comments and resubmits the CNA, the process is repeated until the Assigner is satisfied that all CNA and other underwriting requirements have been addressed and a Firm Commitment can be issued, whereupon the Assigner “approves” the CNA. Attachments and reports from the approved CNA may be printed for use as attachments to the Firm Commitment as needed. The approved CNA, including all attachments, is recorded permanently in the CNA eTool database and can be retrieved for comparative purposes and/or for use in asset management functions.
2. **Reviewer.** Reviewers receive assignments from Assigners. Generally, reviewers are underwriters and/or technical staff. The CNA eTool reviewer assigned to the application can open the CNA in the Reviewer Tool. Reviewers have access only to CNAs assigned to them. Reviewers use the Reviewer Tool to analyze the assigned CNA, enter comments both general and specific and upon completion of review indicate that the CNA is “ready for decision.” A Reviewer may “reassign” to another reviewer a CNA assigned to him which enables staff to share work or solicit assistance. When satisfied that all relevant and material issues have been identified and noted in comments, the reviewer changes the CNA status to “ready for decision” whereupon the assigner is able to consider the reviewer’s

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work, modify the reviewer's comments and either assign it back to the same or another reviewer for further work, return it to the lender for the lender to address comments, or approve the CNA.

3. Viewer. A viewer is any staff person who regularly needs to see CNAs but not act on them.

### D. Work-sharing.

The Reviewer Tool portal of the CNA eTool supports work-sharing across all HUD offices geographically and among different program offices, e.g., Office of Multifamily Production, Office of Recapitalization, and Office of Asset Management and Portfolio Oversight.

### E. Detailed Instructions for Users.

Detailed instructions for users are available at the CNA eTool homepage and specifically in the CNA eTool Internal User's Manual.

- F. Timely consultation and review by others, appropriately experienced, HUD staff may expedite applications and avoid delays at closing. In particular, survey issues, proposed easements, and joint use and access agreements that impact design, construction or operating expense estimates should be reviewed by Regional Counsel before final underwriting is completed.