BedfordLending

General Contractor 221(d)(4) HUD Financing Overview

Any general contractor ("GC") that constructs or rehabilitates multifamily assets via the 221(d)(4) program must have a strong financial position, prior experience building/rehabilitating projects similar in size and scope to any project they are planning to work on, and have a positive reputation.

General Considerations

- **In all HUD 221(d)(4) projects, prevailing wages must be paid to workers** and the use of electronic payroll software will be required to ensure adequate wages are being paid throughout construction. Please see the following guidebook published by HUD for more information: Davis Bacon Guide 2022.pdf Applicable prevailing wage rates may change up to the date of closing and we must incorporate the most recently published wages in the construction budget, however there is no change in wage rate required after construction commences.

- HUD's requisition / draw process is done monthly and is similar to other forms of financing. The draw process is as follows:

1. Contractor, Architect, Owner and HUD Inspector schedule a monthly draw meeting at the site to review construction payment application.
2. Contractor prepares Contractor's Requisition, form HUD-92448, monthly for work in place, along with updated construction progress schedule and reviews with Architect and HUD Inspector.
3. Contractor, Architect and HUD Inspector approve and execute HUD-92448
4. Contractor provides copy of executed HUD-92448 to Owner for preparation of Owner's Application for Advance of Mortgage Proceeds, form HUD-92403.
5. Owner submits executed HUD-92403, executed HUD-92448 and all supporting documentation to Lender for review and processing.
6. Lender reviews/approves monthly draw submission, orders title date down, ensures no liens then funds draw and provides copy of approved draw package to HUD.
7. After each site visit, HUD Inspector issues TRIP (inspection) report to HUD.
8. HUD reviews acceptability of TRIP report and provides copy to Lender.

The receipt of monies requested as part of a draw is typically received by the GC within 30 days. The contractor's requisition is signed off in the field when HUD goes out for an inspection. The requisition then goes to the borrower to be included with their monthly construction draw. Often, we see delays because the borrower is waiting on other invoices from various parties to include with their draw. Once we receive the construction loan advance from the borrower it takes about a week to fund. That includes submitting the draw to HUD for signoff, title updates, etc.

- Retainage will start at 10% of each draw and can reduce to 5% at 50% construction completion and 2.5% at 75% construction completion. A reduction in retainage is subject to approval from the bonding surety, and the HUD Construction Inspector must confirm there are no concerns or issues with the work completed to date before retainage will be reduced.

If the general contractor owns more than 5% of the proposed mortgagor entity (ABC Apartments, LLC, etc.), the amount of retainage will **not** prorate downwards (10%, 5%, 2.5%) as construction is completed, and the retainage balance will generally not be released until project completion.

- Change orders are detailed as follows:

All changes to construction drawings & specifications and requests for time extensions must be submitted on form HUD-92437, Request for Construction Changes on Project Mortgages, and include supporting documentation, along with a letter from the Architect classifying the change as one of the following:

- Necessary Latent (hidden) conditions; changes in building codes, ordinances, etc. after initial closing; architect's/engineer's omissions; damage to completed construction.
- Betterment Economically justified by increasing net income, reducing long-term maintenance and/or operating expenses or otherwise enhances the mortgage security.
- Equivalent Substitution, if specified item is no longer available or it reduces contract price; must provide equal or better utility and performance.
- Time Extension Delay is beyond Contractor's control and documented or associated with an approved change order; accompanied by Surety's written consent, if applicable.

The HUD-92437 must be initialed by the HUD Inspector and signed by the Borrower, Contractor, Architect & Lender then submitted by the Lender to HUD for approval.

- Lender ensures that there is adequate funding for all proposed change orders.
- Payment for approved and completed change order work is billed separately using form HUD-92464M, Request for Approval of Advance of Escrow Funds.
- HUD-92464M includes certification by Architect and HUD Inspector that all work covered by the change order has been acceptably completed in accordance with contract documents.
- Substantial Rehabilitation Projects: Contingency funds are included in the mortgage and used to fund approved "necessary" change orders. After substantial rehab is complete, any remaining contingency may be used for further upgrades/betterments, an initial deposit to the replacement reserve or to reduce the mortgage principal balance.
- New Construction Projects: Contingency reserve (2% of the loan amount) is established within the Working Capital Escrow funded by the Borrower and used to pay for approved "necessary" change orders and construction cost overruns. Any unused contingency is returned to the Borrower at final endorsement closing.
- Approved "betterment" change orders are not funded from above described contingencies during construction; Lender establishes a separate escrow funded by other sources.

If the GC has concerns about change order timing, HUD does allow for emergency changes (i.e., something that could halt construction or endanger life or property) to be completed without having to wait for approval/paperwork. The GC can also put together a potential change order log ("PCO") in advance so that all parties are informed of what changes may be forthcoming to mitigate turnaround timing. Similarly, if changes or drawing clarifications have **no cost** involved, the architect may issue an ASI (AIA G710 – Architect's Supplemental Instructions) in lieu of a change order. But that is only if the cost impact is zero dollars.

- Contractors must be able to secure a payment/performance bond in the size of 100% of the construction contract. The cost of the bond is mortgageable. Alternatively if bonding is not available, a HUD “Completion Assurance Agreement” (form HUD-92450) can be used, however this requires a cash deposit or letter of credit equivalent to 15% of the construction costs (25% for projects five stories or higher), and is very rarely used.

- GCs are considered a principal in the transaction regardless of whether there is a relationship between the developer and the GC. **The GC will be required to provide multiple years of financial statements, current balance sheet(s), a list of projects in progress, resume, proof of licensing, and more.**

- HUD’s construction contract (form HUD-92442M - https://www.hud.gov/sites/dfiles/OCHCO/documents/92442M.pdf) will be used as the master construction agreement, **with no exceptions**. A **lump sum** contract is feasible if there is no relationship between the borrower and GC, if there is a relationship, the contract format must be **cost-plus** and the general contractor will have to cost certify along with ownership. The HUD-92442M includes a damages clause in the event the general contractor does not complete the project on time.

The last two bullet points discuss a “relationship” between parties. HUD uses the term “identity of interest” or “IOI” to describe this “relationship” which is effectuated upon:

1. Any financial interest of the Borrower in the General Contractor or any financial interest of the General Contractor in the Borrower.
2. Any officer, director, stockholder, or partner of the Borrower is also an officer, director, stockholder, or partner of the General Contractor.
3. Any officer, director, stockholder, or partner of the Borrower has any financial interest in the General Contractor; or any officer, director, stockholder, or partner of the General Contractor has any financial interest in the Borrower.
4. The General Contractor advances any funds to the Borrower.
5. The General Contractor supplies and pays, on behalf of the Borrower, the cost of any architectural services or engineering services other than those of a surveyor, general superintendent, or engineer employed by a General Contractor in connection with its obligations under the construction contract.
6. The General Contractor takes stock or any interest in the Borrower corporation as consideration of payment.
7. There are any side deals, agreements, contracts, or undertakings entered into or contemplated, thereby altering, amending, or canceling any of the required closing documents, except as approved by the Secretary.
8. Any relationship existing (e.g., family) which would give the Borrower or General Contractor control or influence over the price of the contract or the price paid to the subcontractor, material supplier, or lessor of equipment.

The conditions that would cause an architect to have an “identity of interest” between parties can be seen on page 3 of the following form: https://www.hud.gov/sites/documents/92408-m.pdf

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Fees

- Acceptable GC “fees” are as follows:

General Requirements should be between 4% and 7% of hard costs. The contractor is required to provide a breakdown of fees when requested or if the value exceeds 7% of hard costs.

General Requirements typically include:

i) Supervision and job site engineering.
ii) Job office expenses directly related to the project, including clerical wages.
iii) Temporary buildings, tool sheds, shops and toilets.
iv) Temporary utilities for construction.
v) Temporary walkways, fences, roads, siding and docking facilities, sidewalk and street rental.
vi) Construction equipment rental not in trade item costs.
vii) Clean-up and disposal of construction debris.
viii) Medical supplies and temporary facilities.
ix) Watchman's wages and security cost.
x) Theft and vandalism insurance (does not include Builder's Risk Insurance).
xi) Builder's Risk Insurance (if premiums are contractor's responsibility)
xii) Salaries of owners, partners or officers of the general contracting firm are not part of general requirements

General Overhead is fixed at 2% per HUD. Always compute general overhead as 2% of the total cost of land improvements, structures and general. Overhead is defined as the cost of continuing operations of a building construction firm.

Builder's Profit is the return anticipated for providing building construction services under competitive conditions and typically in a range from 4% to 8% depending upon the size and complexity of the project. Exceptions are the use of BSPRA (Builder's and Sponsor's Profit and Risk Allowance).

Bond Premium is the typical cost for various bonds required for building construction and is seen in a range of 0.7% to 1.3% of construction costs.

- Regarding incentive fees:
    - Incentive fees added to the HUD construction contract (HUD-92442M) must be disclosed during underwriting and approved by HUD. When there is a formal relationship (an "identity of interest") between the borrower and general contractor, the general contractor may benefit from savings in construction interest, taxes, property insurance, and mortgage insurance premiums to the extent there are construction cost overruns. The certified cost overruns must not have been included in a HUD-approved change order, and the amount of the incentive fee may not exceed the amount of certified cost overruns that were incurred.
    - When there is no relationship between the borrower and general contractor, incentive fees must be calculated in accordance with form HUD-92443. The incentive fee computed for lump sum construction contracts may not exceed 50% of the amount by which the estimated interest, taxes, property insurance and mortgage insurance premium exceeds the certified costs for these same items through the actual date of completion. The incentive fee computed for cost plus construction contracts may be paid in an

amount calculated in accordance with the incentive payment computation on page two of form HUD-92443. Additionally, when the cost-plus contract is used the contractor may not receive total payments that exceed: (1) the actual costs of construction, (2) the cash fee provided in the construction contract, or (3) the incentive fee as determined by the computation. (The contractor shall not be paid an incentive fee that is greater than the amount of cost overruns; the contractor must only receive the amount of the incentive fee. Any excess of this amount must be refunded to the Borrower.)

- Regardless of a relationship between the owner and general contractor, the general contractor will not collect general overhead or builder's profit if more than 50% of the construction contract is subcontracted to one subcontractor, material supplier or equipment lessor, or more than 75% of the contract is subcontracted with three or less subs, suppliers, or lessors. If two or more subcontractors have any common ownership, they are considered one subcontractor. This rule is not applicable to manufacturers of industrial housing, or trade items performed by persons on the general contractor's payroll.

- Regarding architect's fees:
    - HUD lumps architect fees into two categories, "design" and "supervisory". This will be memorialized under an AIA B108 Agreement and is generally a 75%/25% fee split.
    - In the event the borrower has a formal relationship with the project architect (an "identity of interest"), the architect's design fee shall not be considered a mortgageable expense, and an independent supervisory architect must be brought in for the construction phase.
    - In the event the general contractor and architect have a formal relationship, but neither has a relationship with the borrower, the design fee is generally considered mortgageable (subject to HUD review/approval), however an independent supervisory architect must be brought in for the construction phase.

- A borrower may pay an affiliated ("identity of interest") general contractor an actual builder's profit **or** utilize BSPRA (*the "BSPRA" credit cannot be paid in addition to a builder's profit, it is one or the other*) provided that:
    - The amounts of the fee are 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.

Insurance

Public Liability Insurance on a Commercial General Liability form with limits of not less than $1,000,000 per occurrence, $2,000,000 in the aggregate to protect the mortgagor during the construction phase from claims involving bodily injury and/or death and damage to the property of others, is required during construction. Such Commercial General Liability Insurance must be endorsed to include owners' and Contractors' protective coverage.

Typically this is included as an “Other Fee” on HUD’s 2328 Cost Breakdown sheet (https://www.hud.gov/sites/dfiles/OCHCO/documents/2328.pdf), rather than included in General Requirements:

Subtotal (Lines 44 thru 46)	$ 53,828,403.00	Other Fees		
Other Fees		None	$ -	(costs
Bond Premium	$ 332,000.00		$ -	D
Total for All Improvements	$ 54,160,403.00		$ -	None
Builder's Profit Paid by Means Other Than Cash			$ -	
			$ -	
Total for All Improvements	$ 54,160,403.00		$ -	
Less Line 52		**Total**	**$** -	

ertify that all the information state herein, as well as any information provided in the accompaniement herewith, is true and ac

IUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties (18 U.S.C. 1001, 1010

Builder’s Risk insurance can be carried by the General Contractor or borrower. In a project with multiple buildings, the Builder's Risk may only be for buildings currently under construction at any given time. For example, if a project contains 10 buildings, and construction starts on buildings 1-3, Builder's Risk coverage can exist on buildings 1-3 rather than all 10. Then, as building 1 is completed, it falls off the Builder's Risk and converts to Permanent Insurance, and as building 4 starts, Builder's Risk coverage is added to this building, and so on. This means the coverage amount of Builder's Risk is only for the buildings currently under construction as each building phase begins. These requirements are detailed in the HUD-92447 form (https://www.hud.gov/sites/dfiles/OCHCO/documents/92447.pdf):

(a) Concurrently with or prior to the issuance of mortgage insurance by the Assistant Secretary for Housing-Federal Housing Commissioner of any advance of mortgage proceeds for construction of the property, the Mortgagee shall have in its possession or control and in full force and effect, the standard form of Builders Risk Insurance policy or policies. It shall be written upon the standard Builders Risk Completed Value form, for Fire, Extended Coverage and Vandalism and Malicious Mischief Insurance, in an aggregate amount equal to 100% of the Insurable Value of the completed building or buildings.

(b) The Builders Risk Insurance policy or policies shall show the Mortgagor as the Insured and may also show as additional insureds the general contractor and other contractors and subcontractors, as their interests may appear. Each policy shall carry the standard form of Non-Contribution Mortgage or Mortgagee Clause showing loss, if any, payable to the Mortgagee (name and address) and the Assistant Secretary for Housing-Federal Housing Commissioner, DHUD, Washington, D.C., his successors or assigns, as interest may appear. The original of such policy or policies shall be retained in the possession or control of the Mortgagee and shall be maintained in full force and effect.

Vehicle Liability Insurance with limits based on the State or the District of Columbia’s minimum required liability coverage or not less than $300,000 for one person and $500,000 for more than one person, whichever is greater, to protect the mortgagor for claims for bodily injury and/or death, and not less than $100,000 against claims for damage to property of others arising from the owner's operation of vehicles is required during construction. Such insurance must include coverage for employer's owned, non-owned and/or hired vehicles, where applicable.

Working Capital Position

- The GC must have a working capital position equal to 5% or more of the estimated construction contract, and all outstanding projects in construction. Bonding does not negate this requirement. A sample of this working capital calculation is included on the last page, and HUD's guidance is as follows:

5. General Contractor with Adequate Capital. The general contractor's adjusted working capital position should equal 5% or more of the estimated construction contract.
   a. The instructions for hypothecation (See Section 8.5.C.4) of fixed assets may be applied if the general contractor does not have an acceptable working capital position.
   b. The general contractor's ability to obtain a performance-payment bond does not negate or lessen this requirement.
   c. The working capital amount should be adjusted for projects in construction.
   d. If the general contractor does not have an acceptable working capital position or sufficient fixed assets that can be hypothecated, a joint venture may be established with a financially stronger general contractor provided these firms' combined working capital equals at least 5% of all construction contract amounts for projects in construction and development.
   e. Waiver of the working capital requirement is reserved to Regional Center Directors, and will be considered only when there are specific strongly supported mitigating factors.

If unmet, can secure with line of credit:

5. Net worth in lieu of working capital (hypothecation of fixed assets) occurs when existing assets can secure loans or lines of credit to cover the project's financial requirements and such loans or lines of credit are confirmed as being available. In this case, the underwriter should recommend approval based on "true net worth" rather than on working capital; and require the Active Principal to provide a commitment letter from a lending institution that states:

   a. The rate, amount, term and conditions, if any, of the loan that the lending institution is willing to provide.
   b. The date by which the commitment letter must be exercised. The date must extend at least to the anticipated date for initial endorsement.
   c. The party that will be responsible for repayment of the loan or line of credit, if the commitment is exercised.

      1) Repayment may not be an obligation of the borrower entity.
      2) A certification indicating that the lending institution will not make any claim against the mortgaged property, mortgage proceeds, any reserve or deposit required by HUD, or against the rents or other income from the mortgaged property for payment of the loan or line of credit. This certification must contain the criminal certification found in Appendix 8A.

Cost Certification

If the general contractor has an "identity of interest" with the borrower and/or if a cost-plus contract was used (regardless of an identity of interest), the general contractor must cost certify.

In rare scenarios where the HUD loan equates to less than 80% of project replacement cost *and* the project will benefit from LIHTC, historic tax credits, or new market tax credits, cost certification is not required.

Subcontractors, equipment lessors, material suppliers, and manufacturers of industrialized housing must cost certify where there is an “identity of interest” between those parties and the borrower or contractor (in scenarios where when the contractor must also cost certify) when the total of all subcontracts, purchase, and leases are more than 0.5% of the mortgage.

HUD will notify all parties between 70-80% of construction completion to prepare for cost certification, and a “kickoff” call will be held no later than 90% completion between all parties. Projects involving less than 40 units can qualify for a more streamlined form of cost certification. The purpose of cost certification is to ensure the “final” mortgage amount is not over or understated based upon costs incurred during construction.