

## CHAPTER 5. ENDORSEMENT THROUGH COMPLETION OF REHABILITATION

- 5-1. ENDORSEMENT. The endorsement procedure for cases is dependent upon whether or not the mortgage involves the insurance of advances. If DE processed, the lender prepares the processing and closing documents (including one set of architectural exhibits) and submits them to HUD for endorsement of the mortgage.
- A. No Insured Advances. Cases not involving insured advances are to be endorsed only after all work has been satisfactorily completed, following instructions contained in HUD Handbook 4165.1. Endorsement for Insurance for Home Mortgage Programs, Chapter 1, paragraphs 1-1 through 1-8. Paragraph 1-9(d) is not applicable.
  - B. Insured Advances. Cases involving insured advances are eligible for endorsement once mortgage proceeds have been disbursed to the mortgagor, to the mortgagor's creditors for his/her account and with his/her consent, or to the Rehabilitation Escrow Account, assuming other conditions of the firm commitment have been met. The closing documents must include an original Rehabilitation Loan Agreement executed by both the lender and mortgagor.
  - C. Issuance of Mortgage Insurance Certificate. Following the endorsement, Form HUD-59100, Mortgage Insurance Certificate, is mailed to the lender; place one copy in the HUD Case Binder.
- 5-2. REHABILITATION PERIOD. HUD (Architectural Branch) monitors the progress of the work during the rehabilitation construction period.
- A. Rehabilitation Construction Period. Begins when the mortgage loan is closed. If work is not started within 30 days, or if the work ceases for more than 30 consecutive days, or is not progressing reasonably during the rehabilitation period, the lender may consider the loan to be in default.

The length of the rehabilitation period will be no longer than six (6) months. However, the lender should not allow a time period longer

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than that required to complete the work. Where the rehabilitation work is not complicated, or where a contractor should be able to accomplish the work in a reasonably short time frame, a 2 or 3 month rehabilitation period would be justified. If a shorter time period less than six months is specified in the Rehabilitation Loan Agreement, and the work is not completed within that time frame, the borrower/builder must request an extension of time on Form HUD 92577 for consideration, providing adequate documentation to justify the extension.

If the work is not complete within the six (6) month period, the lender should verify the status of the work and notify the Field Office and request a field review of the property. DE Lenders can approve extensions within the 6 month window, however, the Field Office Architectural Branch must concur on any time extension over the 6th month time period following closing. An extension can only be granted if the loan payments are current.

In cold climate areas, some exterior work items may be impossible to complete. Owners and contractors should try their best to complete this work when the weather is not a factor. However, if closing occurred in mid-winter, it may be difficult to schedule these exterior items. Submit Form HUD 92577, with adequate documentation, to request an extension for weather related items.

- B. Change Order Request (Form HUD 92577). Prepared by the borrower, or builder, and submitted through the lender, to HUD or the DE Underwriter for acceptance. The Change Order Request is used for contingency items and other changes that may increase or decrease the cost of rehabilitation and/or the value of the property. Work must be 100% complete on each change order item before release of any monies to the borrower, or builder.

The contingency reserve can only be used on those changes that affect the health, safety, or items of necessity of the occupants. If the contingency reserve is insufficient, the borrower must place additional

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monies into the account for payment upon acceptance of the change. If a change order results in a decrease in costs, the amount will be added to the contingency reserve. Additional improvements that do not affect the health and safety, or an increase in cost due to a necessity item, must be paid for by the homebuyer and not paid out of the contingency reserve fund. If the work is complicated, a 10 to 20 percent contingency reserve may be added to the change order request.

- C. Release of Funds (Draw) from the Rehabilitation Escrow Account. The lender (originating or secondary) who controls the Rehabilitation Escrow Account should release monies to the borrower (and builder, where applicable) within 24 to 48 hours after receipt of a properly executed: (1) Draw Request, Form HUD 9746-A, see Appendix 9; (2) Compliance Inspection Report, Form HUD 92051; (3) Title update, where necessary; and (4) Fee inspector's bill if the payment will be released from the Rehabilitation Escrow account. Funds may be released under the following conditions:

- 1) Initial draw may be released at loan closing. Allowable fees

paid by the borrower, or on his/her behalf, may be reimbursed provided they are listed on Form HUD 92700, 203(k) Maximum Mortgage Worksheet (Appendix 11).

Permits from the local or State building authority are required, where necessary. Actual cost of permits and other fees will be paid at the initial draw at closing. Excess in estimated fees must be put in the contingency reserve.

Under no circumstances is a draw request to be approved for work that is not yet complete, including materials that have been paid for but not yet installed. An exception may be allowed for kitchen and bath cabinetry, or floor covering, where a contract is established with the supplier and an order is placed with the manufacturer for delivery at a later date. Release of any of these items must be authorized on the Conditional Commitment/ Statement of Appraised Value, Form HUD 92800.5B.

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- 2) Intermediate draws (four maximum) are inspected by the HUD assigned fee (or DE staff, where applicable) inspector (see paragraph 4-9). If the cost of rehabilitation exceeds \$10,000, then additional draw inspections are authorized provided the lender and borrower agree in writing, and the number of draw inspections are shown on Form HUD 92700, 203(k) Maximum Mortgage Worksheet.

The inspector visits the site with the accepted architectural exhibits. Improvements must be satisfactorily completed in compliance with industry standards, local practices and to the satisfaction of the fee inspector. Escrowed funds may be partially released based on the percentage of completion of each line item shown on Form HUD 9746-A. If the work is acceptable, the inspector completes a Form HUD 92051, Compliance Inspection Report and the Draw Request (Form HUD 9746-A), and sends it to the DE Underwriter or to HUD for review. A holdback of 10 percent (10%) will be made on all intermediate draws.

If the owner does the work and it only cost 60% of the line item for materials, upon completion of the work item, the draw release would be 100% minus 10% holdback, thereby paying the owner for the "sweat" in completing the work. If the owner subcontracts the work for less than the line item, then 100% of the line item would be released upon completion minus the 10% holdback.

The lender or HUD may determine that additional compliance inspections are required throughout the rehabilitation period to ensure that the work is progressing in a satisfactory

manner. Release of funds is not authorized on this type of inspection, however, the borrower is responsible for paying the inspection fee. A lender may require a property inspection if there have been no draw requests for 30 days or more.

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- 3) Contingency item inspections will be assigned to the fee inspector by the lender. The inspector will complete a Compliance Inspection Report, Form HUD-92051, and return the report to HUD/DE underwriter. If acceptable, HUD/DE underwriter prepares Contingency Release Letter (Appendix 6) and sends it to the borrower. Partial release of contingency items is unacceptable. The work for each contingency item must be complete and in compliance with industry standards. Ten (10) percent (10%) holdback is required.
- 4) Final Inspection will be approved when all work has been satisfactorily completed in compliance with industry standards, local practices and to the satisfaction of the fee inspector (refer to paragraph 4-9). The borrower must provide a letter to the lender requesting final inspection and indicating that the work is satisfactorily complete (see Appendix 5). Upon receipt, the lender will schedule the inspection with the inspector. The inspector visits the site, makes the inspection to determine whether or not the work has been completed according to the accepted exhibits and completes the Compliance Inspection Report (Form HUD-92051) and the Draw Request (Form HUD 9746-A, Appendix 9). The inspector returns the report to HUD or the DE lender.

Note: See paragraph 1-9.B. for instructions on releasing interest accumulated in the Rehabilitation Escrow Account.

- D. Mechanic's and Materialmen's Lien Waivers. Lenders are advised to obtain legal counsel and should obtain lien waivers at the time of any disbursement of funds from the Rehabilitation Escrow Account. Lenders are responsible to ensure the validity of the first lien on the property. It is suggested that all disbursements be made by check or money order, through the lender (or its agent).

Endorsement of the check by payee (and payment of same) acknowledges payment in full of any and all claims which payee has, to date of the check, and specifically releases all rights to claim a

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mechanic's lien for material furnished and/or labor performed upon the property. The payee represents in obtaining the payment that all bills for labor and/or materials furnished by, through or under payee have been paid in full.

- E. Final Release Notice. Issued by HUD or the DE Underwriter after reviewing the case file to ensure that all work has been satisfactorily completed (see Appendix 7). If an occupancy permit is required by the local jurisdiction, it must be provided prior to the issuance of the Final Release Notice.

Acceptance of the final inspection report will authorize the release of all monies remaining in the Rehabilitation Escrow Account, including all holdbacks from previous draws. However, if required to protect the priority of the security instrument, the lender may retain the holdback, for a period not to exceed 35 days (or the time period required by law to file a lien, whichever is longer), to ensure compliance with state lien waiver laws or other state requirements. A copy of the final inspection report and Final Release Notice will be provided to the borrower.

If there are unused contingency funds, inspection fees or mortgage payments remaining in the account, the lender must apply the funds to prepay the mortgage principal. Also see paragraph 3-2.J. After final distribution of all escrow monies, the lender must notify the Field Office of completion and provide an accounting of all funds (see Appendix 13).

- F. Foreclosure of Mortgage During Rehabilitation. In the event of a default and subsequent assignment of the mortgage or conveyance of the property during rehabilitation, the lender is to notify the Chief of the Architectural Branch by letter that a final inspection is being made in order to compensate the contractor for all work completed to date of assignment.

The fee inspector is to document on the Compliance Inspection Report (Form HUD 92051) and the Draw Request (Form HUD 9746-A, Appendix 9) the amount of work that has been completed since the start

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of construction. HUD or a DE Underwriter will determine the value of the completed work and authorize the release of escrow funds. Using a format similar to the Final Release Notice, authorize release of payment for completed work, as well as the release of holdbacks on advances previously released (do not release the money to the borrower). Lender is to submit a copy

of the Final Release Notice with claim for insurance benefits. If funds remain in the escrow account, the amount of the claim (the unpaid principal balance) must be reduced by the unexpended funds remaining in the account.

- 5-3. DISPOSITION OF CASE BINDER. Case binders for mortgages involving insured advances are retained in the Field Office until the completion of the rehabilitation construction, then shipped to Headquarters in accordance with outstanding instructions.