



**Delegation of Non-Critical Repairs Best Practices**  
**Final Version of Document Proposed for Potential Use by FHA Servicers 9/30/2013**  
**MBA FHA SERVICERS SUB-COMMITTEE**

**A. Requirements Overview**

Often repairs are identified at underwriting that cannot be corrected prior to closing the loan. In situations like this, a Non-Critical Repairs escrow is established to complete the work. The Escrow Agreement for Non-Critical, Deferred Repairs HUD-92476.1M (the "NCR Agreement") documents the repairs to be completed, the terms for completing the repairs and the disbursement of escrowed funds. The Addendum to Form HUD-92476.1M Escrow Agreement details the processing of requests for disbursement of funds from the escrow repair account. The repair items covered by the NCR Agreement can vary widely, however they are always intended to improve the physical condition of the property securing the loan.

Prior to closing of the loan, the closer verifies that the repair information is consistent between PCNA, firm commitment, and the NCR Agreement. The estimated third party inspection fees, title bring down and any administrative fee are collected at closing.

NCR Agreements are short-term agreements that generally expire in 12 months after closing, and sometimes have shorter deadlines for individual repairs requiring more immediate attention. Work as identified in the NCR Agreement is required to be completed by the expiration date, or earlier deadlines established for select repairs.

**INSPECTOR QUALIFICATIONS:**

Inspections can either be conducted by in-house staff (if local or part of a pre-scheduled trip for other annual inspections) or ordered from an approved vendor certified by REAC, MBA, ASHI, NACHI or HANI. If a vendor is engaged, the Servicer should confirm the scope, turnaround time and the cost. Be very specific in relaying the scope of the inspection to the vendor to make sure the quoted cost is accurate.

Third party documentation (government/permit inspections) to certify that the work was completed according to specifications including compliance with local building and safety codes may be accepted in lieu of an inspection based upon Servicer discretion.

**B. Set-up and Monitoring of Completion**

During the new loan set-up process, the escrows are set up and all repair items with associated cost and completion deadline are input into the Tracking System. The Servicer is responsible for reviewing the NCR Agreement and monitoring the completion progress. The Servicer should review the tracking system on a regular basis; to check for near term expirations. The Servicer should contact the Borrower advising them of any near term deadline and to request a status of the work.

**C. Initial Borrower Contact**

After an Asset Manager is assigned a newly closed loan, they should initiate contact with the Borrower to discuss the Non-Critical Repairs to make sure the Borrower is aware of the pending deadline and initiates work on the repair items:

1. Upon request, the Servicer will provide to the borrower instructions on how to request a disbursement, with instructions regarding how to request a reimbursement, complete the form HUD 92464M, including providing copies of the HUD 92464M, the Escrow Agreement, Owner's Certification, and an internal Non Critical Repair worksheet that allows for more details explanation and tracking of required works and progress of repairs.
2. In addition, the Servicer or borrower may at any time request to schedule a conference call to discuss the specific scope of work, timing and requirements for submitting draw requests. During the call interim deadlines should be established, if necessary, for tracking the Borrower's progress toward completing long duration line items (exterior painting, unit rehabs, etc.). The Servicer should stress the importance of completing all work prior to the expiration of the escrow period.

**D. Disbursement Frequency and Other Disbursement Limitations**

Because of the costs associated with frequent draw requests, interim disbursements are typically limited to (a) once per Quarter and (b) in an amount in excess of \$5,000; however, these may have been modified for an individual loan (e.g. to once per month). Exceptions to the frequency of disbursements or to the minimum disbursement amount may be approved on a case-by-case basis by the Servicer, as stipulated in the Addendum to Form HUD-92476.IM.

Funds held by the Servicer under a NCR Agreement are intended to be available to reimburse the Borrower for costs incurred by the Borrower in carrying out repairs, replacements, or improvements that are specifically identified in the NCR Agreement. Labor expense related to the installation or replacement of approved items may be reimbursed, but not for regular staff salaries. These must be contracted labor and be well documented.

The Servicer may disburse funds to the Borrower only if it has received all required documentation from the Borrower and has determined that all applicable conditions for disbursement have been met, including (but not necessarily limited to) the following:

- all repairs, replacements, or improvements covered by the requisition must have been completed in a good and workmanlike manner, as evidenced by the Borrower's submission and, if appropriate, the Servicer's or a qualified professional's inspection of the completed work (see guidance on inspections above);
- all related invoices for items and services covered by the requisition must have been paid;
- there must not be any outstanding mechanic's or materialmen's liens that have not been properly bonded off;
- Servicer may, on a case-by-case basis allow for joint payable checks made payable to the vendor and the project to satisfy payment for work completed, but not yet paid for by the project.
- Servicer may, on a case-by-case basis allow for joint payable checks made payable to the vendor and the project to satisfy deposit requirements for contracted work not yet performed.

The amount disbursed by the Servicer to the Borrower in response to any requisition, other than the final requisition, may not exceed 90% of the actual cost of the repairs, replacements, or improvements covered by the Borrower's requisition.

## **E. Reviewing an Interim Request**

### **1. Request Review**

The review of the request is to verify two major categories (1) the identified repair has been completed in a satisfactory manner and (2) whether the contractor/vendors/suppliers that performed the repair work have been paid. The Servicer will review the documentation required to confirm completion of the work and that payment has been made by the Borrower. Each requisition submitted by the Borrower must be accompanied by:

- completed HUD Form 92464M
- the Request Form listing (a) the specific repairs, replacements, or improvements for which reimbursement is being sought; (b) the quantity and price of all materials (grouped by type or category) or specific replacement items (e.g., appliances) purchased in connection with the repairs, replacements, or improvements for which reimbursement is being sought; and (c) the cost of all contracted labor or other services involved in completing the repairs, replacements, or improvements for which reimbursement is being sought.
- a certification by the Borrower that the repairs, replacements, or improvements covered by the requisition have been completed: (a) in a good and workmanlike manner, (b) in accordance with any plans and specifications previously approved by the Servicer, and (c) in compliance with all applicable laws, ordinances, rules, and regulations of any governmental authority, agency, or instrumentality having jurisdiction over the Property; and
- copies of invoices and evidence of payment for all items/materials purchased, and all labor/services provided in connection with the repairs, replacements, or improvements; and
- for larger items, copies of bids or contracts outlining the scope of work; and
- release of lien from each contractor, subcontractor, or materialman providing services or materials in connection with the repairs, replacements, or improvements covered by the requisition whose work exceeds the lesser of \$10,000 or 1% of the Mortgage Loan unpaid principal balance; and
- Photographs of completed work; and
- For a final disbursement, a title run-down (from settlement to present), if applicable, at the discretion of the Servicer.

If the package is incomplete, the Servicer should contact the Borrower to obtain the needed information. Upon receipt of the requested information or confirmation that the item(s) in question will be removed from the request, the processing shall continue.

The Servicer will review:

- HUD Form 92464M to make sure it is filled in correctly and signed by the Borrower;
- review all invoices for description of work performed and confirm conformance with repair schedule and PCNA requirements;
- compare photographs provided by the borrower to descriptions and photographs in the PCNA;
- review actual costs vs. budget and approve the lesser of actual cost or budget line item amount, plus contingency. If the contract amount is in excess of amounts held in escrow, discuss with Borrower their plans and ability to pay the shortfalls;
- review evidence of payment (cancelled checks or bank statements are sufficient) / lien waivers (in excess of \$10K);
- issue joint checks for larger items that have not been paid;
- obtain evidence of payment for all items funded on previous draw that had not been paid at the time of the draw submission;
- review inspection report (if applicable) or pictures provided by the borrower to verify completion of work with no issues;
- confirm that the work has not already been reimbursed by reviewing previous disbursements for any invoices/cancelled checks dated prior to the previous disbursement;
- verify all loan payments are current. Requests cannot be processed when loan payments are past due.
- Verify there are sufficient funds in the account to cover the draw. If not, notify the Borrower to determine if they would like to proceed, understanding that they can only receive monies that are available once the request is fully processed.
- It is important that the draw disbursement include the consideration of the hold-back amount, typically 10% of the amount of the draw.

## 2. Inspections

An inspection is required prior to the disbursement of funds in the following cases:

- The disbursement request is over [\$50,000 (Per working group -to be agreed by Servicers Committee), pursuant to 223F requirements;] – Under \$50,000 request before and after photographs.
- Interim payments under a contract, where an inspection is not required, should be documented with before and after photographs provided by the Borrower.
- If the current repair disbursement aggregated with all previous disbursements since the last inspection total the greater of \$100,000 or 50% of the total repair escrow;

Funds held by the Servicer, under the NCR Agreement may not be used to cover any administrative or inspection fees due to the Servicer.

## **F. Reviewing Final Request**

### 1. Request Review

Prior to the time of the Borrower's final disbursement request, in addition to following the steps outlined in E-1 above; the Servicer must document the absence of any mechanic's and materialmen's liens by requiring the Borrower to obtain an updated title report or a title policy endorsement showing that no such liens exist.

The Servicer will adhere to the terms of the NCR Agreement with regards to withholding retainage from each draw, to be released when all work is complete. In cases where the latent defects have not been waived pursuant to the form HUD 92476.1M Addendum, the Servicer will withhold the 2.5% of the total repair amount for 15 months after the completion of repairs (or as otherwise required by the escrow agreement). The Servicer is not required to conduct an inspection to determine that no latent defects exist.

2. Final Inspection:

Servicer will arrange for the final inspection to be conducted by an inspector that meets the requirements as stipulated in Section A. All inspection reports must reflect that all required work has been completed in a good and workmanlike manner.

**G. Disbursement of Funds**

Servicer may release funds to the Borrower only if it has received all required documentation from the Borrower, is satisfied that all applicable release conditions have been met, including obtaining the required internal approvals.

The Servicer determines the final amounts that are eligible for reimbursement, documenting on the HUD Form 92464M which items are not-eligible for funding, indicating any reduced amounts on each line item, and denoting the revised total funding amount. The Servicer will adhere to the terms of the NCR Agreement with regards to withholding retainage from each draw, to be released when all work is complete. After careful review of the disbursement package, an authorized signer of the Servicer signs the form. Upon the signed approval, the Servicer will process the draw and issue a check. The complete disbursement package will be filed in the appropriate folder.

Deposit for Commencement of Work

Dual Party Checks should only be issued if this payment method was approved by the Servicer's Asset Manager in advance of the disbursement request based on a review of the contract for a high cost repairs (roofs, paving, siding, etc.), and if necessary a funding schedule determined for the major project. Multiple advances will require an interim status updates with each funding request, including photographs at minimum and potentially an inspection depending on the size of the request, and unconditional lien waiver for previous disbursement amounts and a conditional lien waiver for the new amount. No dual party check will be issued without a Conditional Lien Waiver from the vendor and a complete W-9 tax form for the vendor.

- The draw is for a dual party check for direct payment to a vendor over the greater of \$10,000 or 25% of the total contract amount under a contract, or for any final payment under a contract (rather than to reimburse for an amount already paid by the Borrower). Interim payments under a contract, where an inspection is not required, should be documented with photographs provided by the Borrower.

**H. Modifications to the Agreement**

Servicer does not have the authority to modify the NCR Agreement or the Addendum to Form HUD-92476.1M, other than for due date extensions, without the approval of HUD. Lender will seek HUD

approval when the Borrower wants to substitute or waive completion of required repairs. The Servicer maintains the authority to approve line item changes (provided no scope has changed) and reallocate funds from over-collateralized escrows to cover cost overruns.

#### 1. Due Date Extensions

If the Borrower desires a date extension, the Borrower must submit a written request with the reason for the extension and an indication of the additional time needed. The Servicer will review requests for additional time to complete repairs, and at their discretion determine reasonability and approve the Borrower's request for an extension. Any extension requiring longer than 12 months from the initial Escrow Agreement date will be submitted to HUD for review and approval. If the request is denied, the Servicer communicates this response to the borrower.

In cases where the Borrower has requested an extension, the Borrower should provide evidence that the Borrower tried to complete the repairs; however, some unforeseen instance hampered the completion date. In borrower's analysis, lender must be provided with line items to be repaired and the impact of the applicable line cost.

Prior to approving the request, the Servicer must verify that (i) the Borrower is not in default and; (ii) the extended items are not life safety. No agreement can be extended more than one year past the expiration date of the NCR Agreement.

If the request is denied, the Servicer communicates this response to the borrower.

The borrower's extension request letter, the Servicer's response and other documentation are scanned and placed in the loan file.

#### 2. Scope Revision

Any borrower changes in scope or work must be approved by HUD.