SECTION 2-12. ADMINISTRATION OF ESCROW AND SECURITY ARRANGEMENTS

2-12-1. PURPOSE. The purpose of the escrow account through which all proceeds of guaranteed obligations must pass to the developer is to assure that, as required by the Act, guarantee assistance is used only to finance land acquisition, land improvements and public facilities and that, at a minimum, 20% of all land acquisition costs and 10% of the cost of all land improvements and public facilities be financed, in the case of private developers, from sources other than Title VII such as equity contributions or earnings. The purpose of the government's security interest in property of the developer is to protect the government against risk of loss should payments under any guarantees be required.

The administration of the escrow and security arrangements provides maximum assurance to the NCDC that these purposes will be served with a minimum burden upon operations of the developer. The escrow arrangements are thus designed to support and facilitate administration of the security arrangements: the escrow account, for example, is made subject to the government's lien, and the cost certification required for escrow disbursements also serves, for security purposes, as a basis for automatic revaluation of real property improved by such costs.

In the case of interest loans, no escrow arrangements are necessary since the indebtedness in respect of which such loans are made may be used under the Act to finance any aspect of an approved new community and at 100% of cost. Security arrangements are, however, required to protect the government against the risk that the interest loan (with interest thereon) will not be repaid.

In the case of a public developer receiving guarantee assistance, escrow arrangements may be waived if financial covenants restrict all activities of the developer and restricted subsidiaries to land acquisition, land improvement and construction of public facilities and if the NCDC is satisfied that security arrangements will be adequate in the absence of the escrow of Title VII proceeds. Such a waiver is possible since the Act permits 100% financing of eligible costs for public developers.
In the case of a determination of general eligibility, neither escrow nor security arrangements are required since neither limited-purpose financing nor financial risk to the government is involved.

2-12-2. SCOPE. This Section describes the procedures by which funds in the escrow account are disbursed to the developer and property is made subject to and released from the government's lien, including procedures for valuation. The Section also describes the limitations on investment of funds held by the trustee. The escrow and security arrangements constitute pieces of the controls by which the government protects its statutory and financial interests while seeking to assure completion of the project on a sound financial basis. The relationship and interaction of all elements of these financial controls are discussed in Section 3-7. The procedures for financial monitoring are discussed in Section 2-13.

2-12-3. PROCESS AND TIMING.

a. Disbursements from Escrow. Eligible costs must be certified by the developer as paid or to be paid within 30 days in a "certificate of actual costs" submitted to the NCDC for approval, subject to adjustment based on year-end audit. The NCDC authorizes the trustee to release from escrow 80% of land costs and 90% of other eligible costs by endorsement of the developer's certificate. The trustee then releases to the developer on demand funds from the escrow account in amounts not exceeding the cumulative endorsements of the NCDC, provided that the level of security value does not fall below 110% of the principal amount guaranteed and that no default has occurred and is continuing. Under certain circumstances, the NCDC may instruct the trustee to withhold up to 10% of the amount endorsed.

(1) Eligible Costs.

(a) Land Acquisition. Disbursement in respect of land acquired by the developer prior to the first closing date is based upon value as determined by the NCDC. The same value will be used for security purposes at the first closing. Disburse-
ment based on present value is designed to eliminate disparities based on time of acquisition. Disbursements in respect of land subsequently acquired by the developer are based upon cost, though for security purposes valuation by the NCDC (which may be more or less than cost) is required. Where disbursement is based on land value, related holding and other costs contributing to value will be disallowed as a basis for disbursement.

(b) Development Costs. Costs of land development and public facilities which may serve as the basis for escrow disbursements are defined under the terms "actual costs" and "land development" in the project agreement (see Appendix 6) which are drawn largely from the definitions contained in the Act. Usually all costs incurred by the developer will be eligible if there has been compliance with the standard financial covenant that the developer and restricted subsidiaries will engage only in activities eligible for financing under the Act. In cases where the developer has obtained the NCDC's approval to undertake other activities benefitting the project (with separate accounting), questions may arise particularly as to the allocation of overhead. In general, for any reporting period, the ratio of eligible overhead to total overhead should be no greater than the ratio of eligible direct costs to total direct costs.

(c) Interpretation. While most costs incurred in development of a new community will clearly fall inside or outside of the categories contained in the project agreement definitions, there will be costs requiring interpretation by the NCDC. Consistent with Congress' clear intent to exclude construction of buildings for residential, commercial or industrial purposes from financing
under the Act, the policy of the NCDC is to construe liberally the application of definitions to embrace doubtful costs of benefit to the project. The Act confers upon the Secretary broad discretion to identify as eligible the costs of unspecified "installations or work, whether on or off the site, which the Secretary deems necessary or desirable to prepare land for residential, commercial, industrial or other uses, or to provide facilities for public or common use." The policy of liberal interpretation takes account of the following factors:

1. Unlike cost certification procedures in other government programs, cost certification under Title VII is not relied upon to prevent funds from being drained away for the benefit of promoters. This purpose is served under the new communities program by dividend restrictions and other financial covenants described in Section 3-7.

2. Any project which throughout the development period financed 90% of land development costs from debt proceeds would be wholly infeasible. A more likely cumulative percentage for a healthy project would be less that 50%. It is obvious that revenues will be used whenever possible in early years to finance more than 10% of eligible costs and that revenues must become adequate in later years not only to finance 100% of costs in those years but to repay the borrowings used to finance a percentage of costs in earlier years, whether 90% or less.
It is therefore highly unlikely over any appreciable term of the development period that escrow disbursements will approach 90% of clearly eligible costs, even though in any given quarter eligibility requirements are liberally construed to embrace costs not squarely within the specific categories of the definitions.

3. One of the purposes stated in the Act is to encourage innovation in new community development. Frequently the costs of innovative features (such as aggregated heating and cooling systems, total energy systems, telecommunication systems, pedestrian platforms sheltering mixed uses, etc.) do not fit neatly into the specific categories of the definitions. In most cases the economic feasibility of an innovative feature will be greatly affected if not determined by the availability of Title VII financing. The public interest in encouraging innovation is served by a liberal rather than a strict interpretation of eligibility requirements for cost certification.

4. Any saving through the use of Title VII financing as opposed to more costly conventional financing is available to assist in achieving the varied social and other public purposes of the Act.

(2) Certificate of Actual Costs. The format for the certificate of actual costs is contained in Exhibit E to Appendix 6. The initial certificate is usually submitted at least one week prior to the first closing and includes the Secretary's estimate of value of land acquired prior to the project agreement, preincurred costs, and closing
costs to be paid within 30 days. Thereafter, certificates may be submitted not more frequently than quarterly.

Costs certifiable are limited to those incurred by the developer entity and restricted subsidiaries but may not include costs paid by one restricted subsidiary to another or to the developer or by the developer to a restricted subsidiary. Costs attributable to development or acquisition of land not currently within the development plan will be disallowed until such time as the development plan is amended to include such development or land. Land development construction costs are eligible only if the statutory prevailing wage requirements have been met with respect to the construction work for which the cost is certified. Weekly payrolls and certifications of the contractor and sub-contractors must be checked for compliance with the prevailing wage requirements.

Payments to persons having any identical interest with the developer must be identified and are closely examined. Evidence is required that any such payment does not exceed the cost of equivalent services from other sources. The NCDC may adjust the amount endorsed to reflect its judgement of reasonable payment in such cases.

The project agreements require action by the NCDC within 30 days after submission by the developer of a certificate of actual costs. The objective of this requirement is to prevent unnecessary processing delays. Questionable items are discussed with developers immediately. They are given a reasonable time to respond with clarifications before items of cost are disallowed.

(3) Secretary's Endorsement. When eligibility of certified costs has been determined, the applicable statutory percentages are applied to determine the dollar amounts to be endorsed to the trustee for release from the
escrow account. The percentages of approved certified costs eligible for release are 80% of actual costs of land acquisition and 90% of actual costs of land development. A certificate of amount endorsed is issued to the developer. The reasons for disapproval of any costs are stated in an attachment to the certificate.

(4) **Annual Adjustments.** Quarterly cost certification by the developer is required to be reviewed and reported upon at the time of annual audit by independent certified public accountants. If the auditor's report reveals any net excess in disbursements over eligible costs, the developer is required to reimburse the escrow account forthwith.

(5) **Withholding from Disbursements.** The NCDC has discretionary powers to instruct the trustee to withhold up to 10% of amounts endorsed on a cumulative basis, to be disbursed at such time as the NCDC may direct but no later than the end of the development period or of any continuing default, whichever is later. Among considerations which might prompt withholding are: inaccuracies in prior cost certification, the progress of work, maintenance of working capital, overruns, and the relationship of cost to value of acquired land.

(6) **Termination of Escrow Account.** Any amount remaining in the escrow account after 10 years must be applied by the trustee to repayment of outstanding guaranteed obligations.

b. **Servicing of Security.**

(1) **Property Subject to Lien.** The lien benefitting the NCDC in the case of guarantee assistance attaches to all the developer's real property interests within the project at the time of execution of the indenture and must attach to all subsequently acquired property at the time of acquisition. Usually this requires the execution and recording of a
supplemental indenture. In the case of an interest loan, however, it is anticipated that only limited property will be required to secure the government's risk of loss and the government's lien need not attach automatically to after-acquired property. Additional property may at any time be made subject to the lien by the developer, including securities issued or guaranteed by the United States or the Federal National Mortgage Association ("FNMA"), cash or other property approved by the NCDC. The escrow account is made subject to the government's lien.

(2) Permitted Encumbrances. The government's lien must be superior to all other encumbrances upon the developer's real property except those specified in the definition of "Permitted Encumbrances" in the indenture. See Appendix 7. These include the usual mechanics liens, utilities easements and minor defects not materially impairing the use intended by the developer, zoning restrictions and leases for 3 years or less. In the case of after-acquired property, any existing or purchase-money mortgage is permitted to provide maximum flexibility for the developer's land acquisition program; but values for purposes of the government's lien will be conservatively appraised. In the case of existing or purchase-money mortgages upon real property owned by the developer at the outset, the NCDC will permit such encumbrances whenever financing terms are more favorable than under Title VII; but again values for purposes of the government's lien will be conservatively appraised.

(3) Valuation.

(a) Appraisals. Real property owned by the developer at the time of execution of the indenture is valued by the NCDC as of the first closing date and subsequently acquired property is
valued by the NCDC as of the date of acquisition. Prior to any such valuation the developer must submit a certificate of survey and a report of an independent appraiser. The NCDC may commission or undertake additional appraisals and will exercise final judgement in all cases. All appraisals and determinations of value will be based on the criteria set forth in instructions to appraisers (Appendix 2).

(b) Certificate of Valuation. Determination of any property value is embodied in a certificate of valuation issued by the NCDC and filed with the trustee. The initial certificate of valuation is issued at the first closing, and the total real property value determined therein will be identical with the total real property value accepted by the NCDC for purposes of disbursement from escrow. In respect of land subsequently acquired, the value determined in a certificate of valuation may differ from the amounts accepted for purposes of escrow disbursement which will be based on cost. Certificates of valuation will also ordinarily be issued at the time the NCDC approves costs certified by the developer, as indicated below.

(c) Development Tracts. To facilitate release of land from the lien of the indenture, the developer, with the approval of the NCDC, will divide all land into discreet development tracts and will apportion among such tracts the certified total value of such land. As project development proceeds, development tracts will usually be further divided and refined with the approval of the NCDC.

(d) Allocation of Costs. All costs of the developer included in a certificate of actual costs and approved by the NCDC
for purposes of escrow disbursement will be deemed additions to security value by issuance of a certificate of valuation. The costs will be allocated among development tracts based on rules contained in the indenture. Direct costs of on-site improvements are allocated to the tract improved. Direct costs of off-site improvements and all overhead costs are allocated to each tract as a proportion of the total acreage or valuation (determined by the NCDC) served by off-site improvements. The costs of off-site improvements and the related share of overhead costs will be excluded, for valuation purposes only, to the extent property outside the project is served by the improvements. Allocation of costs is made to net saleable acres within each development tract, assuring attribution of costs for development of land to be dedicated to related land developed for sale.

(e) Periodic Valuations. Either the developer or the NCDC may request a comprehensive revaluation of security at least once every two years. The determination of value is made by the NCDC in a certificate of valuation based on the criteria contained in Appendix 2 and on any report of an independent appraiser which may have been prepared for either party. The NCDC will closely monitor the effect on valuation of the automatic allocation of approved costs (including overhead) and will exercise its rights to revalue security should any resulting valuations appear unrealistic.

(f) Valuation of Securities. Securities made subject to the lien are valued by the trustee as of such time based on market quotation and thereafter at the
lowest market quotation during the preceding quarter.

(g) Schedule of Security. The trustee is charged with maintenance and quarterly issuance to the developer and the NCDC of a schedule showing the current value for each element of security, which should include each development tract.

(4) Release of Security. Property may be freely released from the lien of the NCDC without substitution so long as the value of property remaining subject to the lien, as reflected in the trustee's schedule of security, is at least 110% of the outstanding principal amount of guaranteed obligations or interest loan. Property to be dedicated for public or community use and not included within net saleable acres may be freely withdrawn irrespective of such limitation. No property may be released, however, during continuation of any default. The developer's request to the trustee for release of security must be accompanied by a certificate of survey (in the case of real property) and by an officer's certificate as to the absence of default. Copies of all papers must also be submitted to the NCDC for information purposes.

c. Investments by the Trustee. Cash held by the trustee for payments on guaranteed obligations may be invested only in time deposits with interest payable to the developer. Funds held by the trustee as security (including escrowed funds) may be invested in 3-year or shorter term debt obligations issued or guaranteed by the United States or FNMA, in certificates of deposit or acceptances issued by approved banks or, under certain conditions, in mortgages insured by the Federal Housing Administration. Investment in high grade corporate bonds has been permitted when promoters of the developer secured acceptable letters of credit guaranteeing reimbursement of up to 5% loss of principal provided that investments registering a 5% loss were required to be sold by the trustee. Income
from investments of funds held as security (other than escrowed funds) is payable quarterly to the developer. Income from investment of escrowed funds is held on the same terms as other escrowed funds (interest on guaranteed obligations during development being an eligible cost for disbursement from escrow). See "Permissible Investments of Trustee" in Appendix 7.

SECTION 2-13. MONITORING AND EVALUATION

2-13-1. PURPOSE. Among the purposes of new community monitoring and evaluation are the following:

a. To assure expeditious, and comprehensive measurement and evaluation of the progress of each new community project throughout the development period in compliance with the objectives and requirements of the Act, the regulations and the agreement between the government and the developer.

b. To provide the NCDC with the opportunity to take preventive action on each project to create a better new community, to end or avoid difficulties on a timely basis as they develop and to assist the developer.

c. To facilitate the retrieval and assembly of relevant data, statistics and information in a uniform format for the purpose of:

   (1) Making realistic comparisons among projects;

   (2) Analyzing new community problems and experiences;

   (3) Evaluating program effectiveness with respect to overall new community goals and in conjunction with national urban growth policy;

   (4) Providing basic educational and training materials for developers and institutions interested and involved in the new community development process.
d. To protect the security interests of the United States.

e. To encourage evaluation and monitoring of the project by the developer himself, independent of federal requirements, pursuant to sound management practices.

**2-13-2. SCOPE, PROCESS AND TIMING.**

**a. Inspections, Audits and Records.** Access to each project site at all reasonable times for purposes of inspection must be assured to the NCDC. The developer and his restricted subsidiaries must maintain, to the satisfaction of the NCDC, records of all costs incurred for the project and must require contractors and subcontractors to maintain similar records. Upon request, all records and all agreements relevant thereto must be made available at all reasonable times for examination by the NCDC and are subject to audit by the General Accounting Office under rules and regulations prescribed by the Comptroller General of the United States. The representatives of the General Accounting Office must be given access to all relevant books, accounts, records, files, papers, and property.

**b. Financial Statements.** Monthly balance sheets and statements of profit and loss, of surplus and of source and application of funds must be furnished to the NCDC. Quarterly statements must also be furnished on a comparative basis. Cash flow projections must be revised monthly. Comparative statements are required on an annual basis and must be audited by independent certified public accountants. Both consolidated and consolidating statements must be supplied, and non-Title VII activities must be segregated. Certificates of no default must be filed quarterly by officers of the developer and annually by independent certified public accountants. All other independent audit reports and all reports supplied to stockholders or the SEC must be furnished to the NCDC. In addition, the developer must submit with each monthly set of financial statements such other financial calculations relating to its financial restrictions and obligations under the project.