TO: Rural Development State Directors

ATTN: Deputy Administrator of SFH Programs
Area Directors
SFH Loan Specialists
Housing Program Directors
State Environmental Coordinators
State Architects

FROM: Tammye Treviño (Signed by Alan Stephens) for
Administrator
Housing and Community Facilities Programs

SUBJECT: Response to SFH 504 findings from the 2010 MCR

PURPOSE AND INTENDED OUTCOME

This Administrative Notice (AN) provides guidance on Agency compliance with construction and development requirements as established in RD Instruction 1924-A, that are critical to the success of Single Family Housing (SFH), 504 Direct Loan and Grant program. Results from the 2010 Management Control Review for the Single Family Housing 504 Program revealed several areas of concern regarding design and construction process and required documentation for projects funded in the 504 Program. This AN shall serve as clarification to the guidance and direction provided in RD Instruction 1924-A, related to construction and the construction process including the need and requirements for a preconstruction conference, the requirements for performing construction with a legal contract, the value and requirements of a builder’s warranty, the requirements for a competitive bid process and the importance of compliance with the HUD/EPA Lead-based Paint regulations as adopted for Rural Development housing.

COMPARISON WITH PREVIOUS AN

There is no previous Administrative Notice on this subject.

EXPIRATION DATE: May 31, 2012
FILING INSTRUCTIONS: Preceding RD Instruction 1924-A
IMPLEMENTATION RESPONSIBILITIES

Field staff involved in the 504 Program Direct Loan and Grant process should review the
construction requirements established in RD Instruction 1924-A and this AN in order to
implement the proper procedures and requirements.

Pre-construction conference: There is a brief explanation in the regulation that describes when
and why there is a requirement to hold a pre-construction conference prior to the commencement
of construction activities. §1924.6 (a) (11):

“(i) Before work commences, the County Supervisor, District Director or other Rural
Development employee having knowledge of contracts and construction practices will hold a
preconstruction conference with the borrower(s), contractor and architect/engineer (if
applicable). The purpose of the conference is to reach a mutual understanding of each party's
responsibilities under the terms and conditions of the contract documents and the loan
agreement during the construction and warranty periods. Form RD 1924-16, "Record of
Preconstruction Conference," may be used as a guide for an agenda.

(ii) A summary of the items covered will be entered in the running case record.”

The pre-construction conference can be led by the Design Architect, when applicable, or Rural
Development staff (State Architect or Rural Development staff with appropriate project
experience). Use of the Form RD 1924-16 or similar form can help organize the event. Specific
issues may be added to the agenda as necessary to cover the major aspects of the project, any
project concerns and the roles of each participating entity. The conference should include
discussions about critical construction activities such as, the foundation, the framing, HVAC and
electrical work. The discussions should also include the contractor’s schedule, payments and
inspections. This is an opportunity to clarify any questions or concerns held by the owner or the
contractor regarding the project.

An effective and well organized conference can be a forum for solutions to possible issues prior
to the activities commencement, essentially avoiding some disputes that cause project delays.
The conference should be used to develop partnerships among the participants, allowing
everyone involved to understand each other’s goals and expectations. The requirements of the
construction contract should be discussed at the pre-construction conference for clarification
purposes only. At this time the contract is an active agreement that may only be modified by a
change agreement signed by all parties.

Construction contracts: The contract will be Form RD 1924-6 and, for more complex
construction, a commercially available document that is considered acceptable by the industry
may be used. The language in the contract should be fair to all parties and be adequate to achieve
the expected outcome. Very specific language will bring the greatest chance of a successful
result. Any requirements that are weak on specifics may open a door for interpretation, risk
exclusion from the agreement or cause the need for a contract change or addition.

Written agreements better protect the owner, Agency and the contractor from misunderstandings,
claims and disputes. When possible, the draft contract should be reviewed by the Rural
Development Staff prior to the final agreement to assess the adequacy of the documents.
Contracts must include: the contract sum; dates for start and completion of the work; amount of
liquidated damages to be charged; the amount, method and frequency of payment; whether
surety bonds will be provided; a requirement that any changes must have prior written approval;
and a list of attachments. Surety requirements in 7 CFR part 1924.6(3), if applicable, must also
be met. The contract documents may include drawings, specifications, and a legal contract with
any standard and special conditions addressed and resolved. Rural Development should be an integral part of the contract and construction document development process for the benefit of the Agency and the applicant. Reference § 1924.5 and 1924.6 of RD Instruction 1924-A:

§ 1924.5 (f)(1) - “(ix) Review the proposed method of doing the work and determine whether the work can be performed satisfactorily under the proposed method.

§ 1924.6 - All construction work will be performed by one, or a combination, of the following methods: Contract, borrower, mutual self-help, or owner-builder. All development work must be performed by a person, firm or organization qualified to provide the service. Conditional commitment construction is covered under 7 CFR part 3550.

§ 1924.6 (a) - Contract method. This method of development will be used for all major construction except in cases where it is clearly not possible to obtain a contract at a reasonable or competitive cost. Work under this method is performed in accordance with a written contract.

Contractor selection: The selection of a construction contractor for a SFH project can be daunting for many as construction projects are rare in the lives of most homeowners. Finding a contractor that has the owner’s best interest at heart takes planning and patience. The process does not have to be formal and extensive, especially if there is no architect or engineer involved, but the owner should take the time to discuss the criteria for the project with several eligible contractors. The discussions with each contractor should be similar in nature and scope so that there is achievement of a selection through a fair and reasonable process.

The construction contract documents should be the basis for the discussions and bids so that comparisons and selections can be made on consistent information. If the contract is awarded through a bidding process, Form RD 1924-5 or a similar form that complies with 7 CFR part 1901, subpart E may be used. The bidding documents should inform bidders of all the contract conditions, and when the bidding opens. In addition, the bidding documents should reveal the owner’s criteria for selection including, but not limited to, the project cost, quality of the components and workmanship and the contractor’s experience and past performance on similar projects. The documents should also ask for background information on any subcontractors that may be involved. Identity of Interests (IOI) should be revealed during the bidding process and handled accordingly. Any criteria for IOI should be clearly described in the bid documents providing a clear understanding for all involved. Reference § 1924.6(a)(10) of RD Instruction1924 A:

“(i) The applicant may select a contractor and negotiate a contract or contact several contractors and request each to submit a bid. For complex construction projects, refer also to §1924.13 (e) of this subpart.

(ii) When a price has already been negotiated or an applicant and a contractor, the appropriate Rural Development official will review the proposed contract. If the contractor is qualified to perform the development and provide a warranty of the work and the price compares favorably with the cost of similar construction in the area, further negotiation is unnecessary. If the Rural Development official determines the price is too high or otherwise unreasonable, the applicant
will be requested to negotiate further with the contractor. If a reasonable price cannot be negotiated or if the contractor is not qualified, the applicant will be requested to obtain competitive bids.

(iii) When an applicant has a proposed development plan and no contractor in mind, competitive bidding will be encouraged. The applicant should obtain bids from as many qualified contractors, dealers or tradespeople as feasible depending on the method and type of construction.

(iv) If the award of the contract is by competitive bidding, Form RD 1924-5, "Invitation for Bid (Construction Contract)," or another similar invitation bid form containing the requirements of Subpart E of Part 1901 of this chapter, may be used. All contractors from whom bids are requested should be informed of all conditions of the contract including the time and place of opening bids. Conditions shall not be established which would give preference to a specific bidder or type of bidder. When applicable, copies of Forms RD 1924-6 and RD 400-6, "Compliance Statement," also should be provided to the prospective bidders.”

Warranty: Warranties are critical to the performance of a construction contract. The terms and conditions of the Warranty provide protection to the owner from latent and unexpected failures, as well as, errors and omissions by the contractor. Either a 1-year or 10-year warranty will be issued by the builder to the borrower. If the warranty protection is for 1 year, RD Form 1924-19 will be provided. For 10-year warranties, RD Instruction 1924-A describes the availability of these plans that are offered by several entities who are able to meet a specific criteria to provide this service. Reference Exhibit L and §1924.12 of RD Instruction 1924-A.

Exhibit L - “I. Purpose: In recent years, numerous third-party home warranty plans have been developed offering new homeowners varying degrees of protection against builder default and/or major structural defects in their homes. This exhibit establishes the criteria and procedures by which a warranty plan is found acceptable for new construction of single family homes financed by Rural Development. An acceptable warranty plan will:

A. Assure that Rural Development borrowers receive adequate warranty coverage,
B. In certain circumstances, eliminate the requirement for Rural Development personnel to make the first two construction inspections, and
C. Permit a loan up to the market value of the security (less the unpaid principal balance and past due interest of any other liens against the security), even though Rural Development personnel may not have performed periodic inspections during construction.

§ 1924.4 (p) - Warranty. A legally enforceable assurance provided by the builder (warrantor) to the owner and the Rural Development indicating that the work done and materials supplied conform to those specified in the contract documents and applicable regulations. For the period of the warranty, the warrantor agrees to repair defective workmanship and repair or replace any defective materials at the expense of the warrantor.

§ 1924.12 (a) - Form RD 1924-19. "Builder's Warranty," or an insured 10-year home warranty as described in Exhibit L of this subpart, and normal trade warranties on items of equipment will be issued to the borrower at the completion of new building construction, dwelling rehabilitation by the contract method, all cases of newly completed and previously unoccupied dwellings or construction under conditional commitments issued to builders and sellers.

(b) If the warranty is not an insured 10-year warranty, a completed Form RD 1924-19 with warranty protection for 1 year, must be provided by the builder upon final acceptance of the work by the owner and Rural Development. If an insured 10-year warranty is provided, the requirements of Exhibit L of this subpart apply, and a copy of the warranty insurance policy or a
binder must have been received by Rural Development prior to disbursement of the final payment to the builder.

(c) If, for some reason, the warranty insurance policy cannot be issued, the contractor will be required to execute Form RD 1924-19 and the case will be forwarded to the State Director for consideration of debarment under the provisions of Subpart M of Part 1940 (available in any Rural Development office). The County Supervisor will assist the borrower to the extent necessary under the provisions of the warranty and Subpart F of Part 1924 of this chapter. (Revised 4-11-89, SPECIAL PN)

(d) The County Supervisor will take the following action prior to the expiration of the first year of the warranty period:

(1) As soon as the warranty has been executed, the follow-up date for sending Form RD 1924-21, "Notice of Expiration of First Year of Warranty," which will be used for the 1 year warranty or the first year of the insured 10-year warranty, will be posted to the "Servicing and Supervision" section of the Management System card.

(2) Form RD 1924-21, is provided for use in notifying the borrower of the expiration date of the first year of the warranty. This letter will be mailed to the borrower early in the second month preceding the expiration date of the first year of the warranty period.

(3) If the County Supervisor or District Director does not hear from the borrower within 30 days, it can reasonably be assumed that no complaint exists or that any complaint has been satisfied unless information to the contrary has been received.

(4) If the borrower notifies Rural Development that any complaint has not been satisfied, an onsite inspection shall be made as early as possible, but not later than 1 month preceding the expiration date of the first year of the warranty. The results of the inspection will be recorded on Form RD 1924-12. If the borrower has complaints, the case should be handled in accordance with the provisions of Subpart F of Part 1924 of this chapter, or as otherwise provided in this subpart.”

Lead-based paint: Standards and regulations published by the Department of Housing and Urban Development (HUD), as well as a federal law developed by the Environmental Protection Agency (EPA), direct and clarify how Rural Development staff should address issues of Lead-Based Paint (LBP) in the renovation, purchase or sale of a residence or child-occupied facility. There is also an LBP Key, which is an interactive flow chart that helps staff determine the necessary actions required for certain types of properties. These documents define the rules that are to be followed and implemented when applicable conditions exist.

A Rural Development AN and the LBP Key have been posted to assist staff with the understanding and implementation of the LBP rules and regulations. The AN also directs staff to resources available from HUD and the EPA for Rural Development internal use and for information that should be shared with applicants/owners.

**POINT OF CONTACT**

Please direct all questions pertaining to this AN to your State Architect or the National Office Program Support Staff: William Downs, Program Support Staff, at (202) 720-1499 or email: william.downs@wdc.usda.gov.