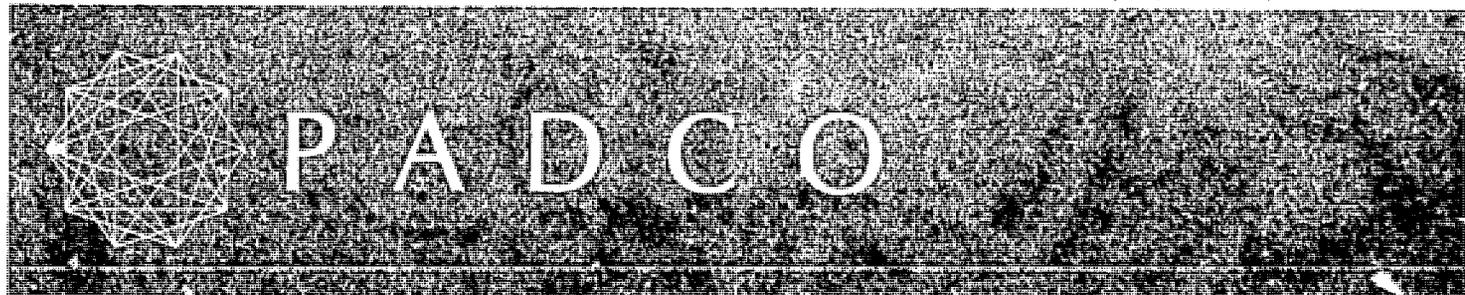


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PLANNING AND DEVELOPMENT COLLABORATIVE INTERNATIONAL, INC.

TRIP REPORT

**PRIVATE SECTOR DEVELOPMENT OF HOUSING
EASTERN EUROPE**

**BULGARIAN POST BANK
SOFIA, BULGARIA**

Prepared for

**U.S. Agency for International Development
Bureau for Private Enterprise
Office of Housing and Urban Programs**

September 1993

PROVIDES GOVERNMENTS AND PRIVATE CLIENTS WITH SERVICES IN PLANNING, HOUSING, MANAGEMENT, FINANCE, ECONOMICS, ENVIRONMENT, GEOGRAPHIC AND OTHER INFORMATION SERVICES, AND TRAINING.

**PRIVATE DEVELOPMENT OF HOUSING
EASTERN EUROPE**

TRIP REPORT

**BULGARIAN POST BANK
SOFIA, BULGARIA**

**Needs Assessment and Program Definition
for Technical Assistance to Bulgarian Banks
Developing Internal Capabilities to Underwrite, Issue and Service
Construction Loans for Residential Development Projects**

Prepared for

**United States Agency for International Development
Office of Housing and Urban Programs
Washington, D.C.**

Prepared by

**William R. Mawhinney, Jr.
PADCO, Inc.
1012 N Street, NW
Washington, DC 20001**

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ABSTRACT

This report represents the initiation of a technical assistance program to the Bulgarian Post Bank (BPB) in construction lending. The proposed technical assistance is to place a mid-term advisor into the BPB to work with its senior staff to develop internal construction lending procedures. This technical assistance program is the result of interest expressed by the BPB and other banks which participated in the USAID-sponsored Construction Finance Workshop in May 1993.

This report contains an overview of the BPB, an assessment of its commitment to construction lending, and an assessment of what the BPB needs in the form of technical assistance as well as staffing and internal procedures to develop an operational construction lending program. The report also outlines a recommended scope of work for the technical advisor who would work to develop the BPB's construction lending capabilities.

The BPB has expressed its intent to become a substantial provider of loans for housing development by hiring experienced personnel, undertaking the formulation of lending policies and procedures and supporting USAID's technical assistance program.

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**Needs Assessment and Program Definition
for Technical Assistance to Bulgarian Banks
Developing Internal Capabilities to Underwrite, Issue and Service
Construction Loans for Residential Development Projects**

1 Assignment

- A. Conduct a specific needs assessment to determine the requirements for technical assistance to improve the Bank's capability to meet the needs for housing development credit.
- B. Develop a detailed scope of work for an advisor to provide required technical assistance.

2 Assessment of Needs

This assessment was determined after interviews with Vanya Vasileva and Reni Petkova, Executive Directors; Bistra Ilkova, Credit Director; and Construction Lending experts. Specific questions relating to the following were used as a basis for the discussion.

- The organizational structure of the Bank and its real estate financing activity
- Credit Policy
- Regulatory issues
- Legal issues
- Internal operations and support systems
- Staffing and training
- Quality control
- Loan origination process
- Loan underwriting process
- Loan approval process
- Loan commitment
- Documentation
- Loan closing
- Loan administration
- Problem loan procedures

The information obtained has enabled the consultant to assess the current status of the Bank's Real Estate lending program and to recommend a scope of work for a technical advisor, which can be found at the conclusion of this report.

At the conclusion of the interviews, the areas recommended for technical assistance were presented to Mrs. Vasileva and Mrs. Petkova, who concurred with the consultant's recommendations.

3 Overview

The Bulgarian Post Bank is jointly owned by Bulgarian National Bank (Central Bank), Bulgarian Foreign Trade Bank and a group of state-owned enterprises. The Bank was established in April, 1991 and is regulated by the Bulgarian National Bank. A plan to merge the Bank with the Bulgarian Foreign Trade Bank has been proposed, but, according to Post Bank representatives, a merger unlikely and, in fact, is given no more than a 5 percent chance of happening.

The Bank, in large measure, was carved from the State Savings Bank, at least to the extent of its representative offices. There had been a Post Bank from 1896 to 1951, when due to centralization, it was absorbed by the newly-formed State Savings Bank. The reconstitution of the Bank in 1991 included reclaiming a large number of branches and representative offices throughout the country from State Savings Bank.

As the name of the Bank implies, it was part of the postal service, with facilities in post offices. Currently, the Bank's main office in Sofia is complemented by a system of 22 branches, providing good coverage, diversified throughout the country.

The Bank's credit activity was begun in 1992. The real estate finance department is staffed by three experts; two of whom were formerly with State Savings Bank. The unit located at the main office is headed by Mrs. Radeva, who reports to Mrs. Bistra Ilkova, Director Credit Department. As of this time, no construction loans have been granted and the unit has been concentrating on developing policies and procedures to govern its future operations.

4 Commitment of Bank to Make Loans for Housing Development

Post Bank has expressed its intent to become a substantial provider of loans for housing development by hiring experienced personnel, undertaking the formulation of lending policies and procedures and requesting technical assistance.

The Bank's commitment was confirmed by Vanya Vasileva and Reni Petkova, Executive Directors of the Post Bank.

5 Credit Policy

The Credit Department has submitted to the Board of Directors its recommended credit policy. The proposed policy, according to Mrs. Radeva, is not extensive.

5.1 Loan Origination and Approval Process

It is intended that loans will originate at the main office and branches. When originated at branches, the credit review and credit verifications will be carried out by the branch experts; project analysis, including reviews of plans and costs, will be conducted by main office engineers. The branch will consolidate an underwriting report and submit it to the real estate unit at the main office for review, and, if in agreement, the real estate unit will concur in a recommendation for approval to the Loan Committee. Branches have authority to approve loans of up to 1,000,000 leva for corporations and up to 50,000 leva for individuals. Officers or experts do not have independent loan authority.

Approvals in excess of the branch limits are referred to the Loan Committee at the main office, which acts as a review and recommending body for action by the Board of Directors.

Loan administration is the responsibility of the originating branch. Disbursements considered to be substantial will be reviewed by the Bank's engineers and real estate unit at the main office.

5.1.1 Underwriting Requirements

There are no established procedures at this time other than the previously-indicated general concept for carrying out this process. Collateral requirements currently are 125 percent of the loan. The Credit Department does not have staff legal or engineering personnel, but does have the support of the Bank's general in-house facilities. While the Bank has engineers, it has consulted with the Bulgarian Building and Construction Chamber (BBCC), which has provided names of firms which could provide technical assistance in evaluating projects and monitoring construction. The underwriting process includes the following:

- plans and specifications
- cost estimates
- evidence of ownership or right to build
- building permit
- site plan
- evidence of pre-sales
- evidence of clear title
- evidence of equity
- verification of borrowers' income, credit history and banking accounts

5.1.2 Terms and Conditions

Amount: No limit stated. These determinations are yet to be made.

Term: To be determined on a project basis.

Interest rates: Structure not established, but expected to be based on cost of funds.

Fees: Have not decided whether or not to require any.

5.1.3 Commitment

There has been no decision with regard to providing the borrower with a commitment letter similar to those issued by U.S. financial institutions, but the possibility is not ruled out.

5.1.4 Loan Closing

To be handled under the supervision of the Bank's in-house legal experts and the civil notary.

5.2 Loan Administration

As previously indicated, will be assigned to the originating branch or with the main office, if that is where loan originated.

5.3 Problem Loan Administration

No provision at this time.

6 Items To Be Considered for Real Estate Loans

6.1 Documentation

Loan agreement, prepared by Bank's lawyer. Two types of mortgage:

- *Contractual*—when lending against property other than the property for which loan proceeds are to be used.
- *Legal*—when secured by collateral for which loan proceeds are used.

NOTE: In some cases, both are used.

6.2 Lien Establishment

Recorded by notary

6.3 Title Clearance

Notary provides certificate of clearance. Does not opine with respect to possible restitution claims. Requires a certificate from notary issued within 24 hours of recording, indicating first lien.

6.4 Restitution

The time for a person to make a claim for real property taken by the government has expired. However, there is a processing backlog of such claims, and in order to ensure that no possible restitution claim exists, an interested party must make a search application through the mayor's office in the community in which the real estate is situated.

7 Internal Operations and Support Systems

7.1 Asset/Liability Management

Does not exist, but Credit Unit does make periodic projections of fund requirements.

7.2 Budgeting

Performed on a bank-wide basis by executive management.

7.3 Staffing

Requests are submitted to Board of Directors. Credit Department currently is authorized 16 staff members, 3 of whom are in the construction loan area. The Bank is considering a bonus form of compensation for lenders.

7.4 Training

On-the-job. No central training area.

7.5 Strategic Planning

There is five-year plan, but there is no quantification for the amount of loans to be originated by the unit.

7.6 Quality Control

Documentation: to be prepared or approved by legal representatives

Loan Review: does not exist

Audit: Bank has an audit unit which will perform this function

7.7 Computer Capability

Reportedly has state-of-the-art hardware with a British software package "FISERF," which has construction loan underwriting and administering capability and capability to generate a variety of reports and forms.

8 Doing Business Problems

The staff of the construction lending unit indicated the following problems associated with developing and operating a construction lending program:

- Recording of mortgage: risk of intervening liens due to lack of notaries to expedite.
- Title clearance: one notary for Sofia, which results in recording delays and uncertainty as to restitution status
- Market: believe that there is an over-supply of housing, particularly in the affordable range, but unable to accurately estimate due to lack of reliable data sources.
- Government does not have a housing strategy
- Appraisal: there is no reliable valuation system
- Insurance: not established in country. Bank is talking with private insurance company about possible coverage
- Inflation: estimated to be 70 percent this year
- Restitution: not a problem with improved property, but problematic in connection with land for construction
- Foreclosure: can take up to 1½ years for Bank to get property in foreclosure proceedings
- Bankruptcy: Bank not protected, but there is supposedly new legislation in process
- Marketing: no experience in business development

9 Recommended Scope of Work for Technical Advisor

9.1 Credit Policy

This Bank will require extensive assistance in developing its Credit Policy. It should be provided with a list of items recommended for inclusion. The advisor can only provide an outline, since the Bank must set its own standards and quantifications. It could be beneficial for the Bank to discuss its reasons for setting credit policies with the advisor. Suggested list of items to be included is attached as Exhibit A.

9.2 Underwriting Guidelines and Procedures

Prior to completion of the assignment, the advisor should provide the bank with comprehensive guidelines which would be reflected in a manual. The manual should indicate the Bank's Credit Policy, specific procedural instructions and the information to be obtained and analyzed. The process should conform to local customs and practices to the extent they are not contrary to good banking practice nor in conflict with the Credit Policy.

The manual should contain forms and exhibits which will assist credit experts in the underwriting process and also serve as the basic training instrument for new personnel and standardize the method by which all of the Bank's construction loans are underwritten.

Attached as Exhibit B are matters to be included in the manual and exhibits to be provided.

9.3 Administrative Guidelines and Procedures

Prior to completion of the assignment, the advisor should provide specific administrative guidelines to be reflected in a manual. The manual should be specific as to disbursement and accounting procedures for all construction loans. The recommended procedures should take into consideration local customs and practices, as long as they do not conflict with the Bank's Credit Policy or good banking practices.

The manual should contain forms and exhibits which will provide sufficient guidelines for those responsible for administering construction loans. The manual can be the basic instrument for training new personnel and standardizing the methods by which all of the Bank's construction loans are administered.

Attached as Exhibit C are matters to be included in the manual and exhibits to be provided.

9.4 Loan-To-Value Ratios

The Bank has requested that the advisor provide assistance in this area. The manner in which the primary and secondary collateral can be used to increase value to allow for adequate loan amounts is one approach that could be explained. Illustrations of determining loan-to-value in U.S. financial institutions can be discussed.

9.5 Appraisal Guidelines

This is a difficult area to resolve, since there is not a system or practitioners recognized for real estate appraisals. There are appraisers, but their experience is in valuing equipment, not real estate. There have been some attempts to establish real estate appraising, and it

would be appropriate for the advisor to determine the current status of the situation before assisting in the establishment of a policy for the Bank.

9.6 Purchase Agreements

The Bank would like the advisor to provide guidelines as to what are acceptable conditions for purchase agreements. These being the agreements which buyers of units will sign indicating their intent to purchase completed housing units and which will be assigned to the Bank.

9.7 Pre-Sale Requirements

The Bank would like assistance in setting a policy concerning pre-sales revenues prior to its approving a construction loan. This matter relates to the previous area and also the amount and type of equity from the borrower.

9.8 Land Exchange and Building Rights

As noted previously, land is obtained by developers as a result of exchanges with landowners, either outright or in the form of building rights. The Bank would like the assistance of the advisor in establishing policy with respect to such transactions. This is, of course, a very different practice than in the U.S. and the advisor must become more fully acquainted with this practice before providing much help.

9.9 Training

Since this is essentially a start-up situation, training of both the staff and management is going to be a priority. Mrs. Ilkova, the Credit Director, has requested that formal training, not just on-the-job program, be used. In particular, it is requested that casework be provided to illustrate concepts and procedures.

9.10 Computer Capability

Review the potential and assist in the implementation of "FISERF" software for underwriting, administering and reporting.

9.11 Loan Structuring

Provide ongoing assistance with loans originating during the assignment.

9.12 Market

Assist in developing ways in which to determine the market for construction loans.

9.13 Business Development

Train credit experts in basic selling skills to include call plans and follow-up procedures.

9.14 Competitive Market

Generally provide assistance in areas which will enable the Bank to function in a competitive market.

9.15 Staff Credibility

Assist the staff in effecting communication with management to enhance its credibility.

9.16 Term of Assignment

It is recommended that an advisor be assigned to assist The Bulgarian Post Bank for a period to cover six months. The assignment would be structured as follows:

Initial Term Field work of two consecutive months on-site. On completing this term, advisor will leave a foundation for each business segment upon which Bank can proceed to develop.

Interim Term Six-week period spent in the U.S. during which advisor will monitor progress of the various segments based on weekly reports which would be faxed by the Bank.

Final Term Field work of two consecutive months on-site. Upon completion of this phase, advisor shall have substantially addressed all areas specified in the S.O.W. in accordance with agenda indicated below.

Preparation and Wrap-Up A two-week period allowing for preparation prior to departure and completing trip report at conclusion of assignment.

9.17 Credit Policy

Initial Term Advisor to recommend items for inclusion in Bank's credit policy based on typical policies of U.S. financial institutions. Explore specific needs and ideas regarded by Bank as essential for inclusion.

Interim Term Advisor to monitor Bank's progress from weekly reports submitted by Bank, and assist as required.

Final Term Assist in completing credit policy and approve final draft before presentation to Bank's Board of Directors.

9.18 Underwriting Guidelines and Procedures

Initial Term Become acquainted with Bank's existing practices and make recommendations for procedures to analyze and evaluate project cost and feasibility and credit worthiness of borrowers.

Provide outline of contents of a manual, including forms and illustrations for various procedures.

Interim Term Advisor to monitor Bank's progress from weekly reports submitted by Bank and provide assistance as required.

Final Term Assist in completing manual.

9.19 Administrative Guidelines and Procedures

Initial Term Become acquainted with Bank's existing practices and make recommendations for procedures to disburse and account for loan funds, establishment of a file record, and document management. Provide an outline of contents of a manual, including forms and illustrations for various procedures.

Interim Term Advisor to monitor Bank's progress in developing manual from weekly reports submitted by Bank and provide assistance as required.

Final Term Assist in completing manual.

9.20 Loan-To-Value Ratios

Initial Term Investigate values to the extent they can be determined. Determine movement up, down or stable. Discuss use of secondary collateral to qualify loans when equity relative to cost is not sufficient.

Interim Term Have Bank personnel continue to accumulate market data which can help the Bank in establishing a loan-to-value policy.

Final Term Assist in establishing loan-to-value term which should be included in credit policy.

9.21 Appraisal Guidelines

Initial Term Investigate what appraisal capabilities exist in Bulgaria. Explore ways in which Bank can establish some guidelines for determining value to qualify loans.

Interim Term Have specific personnel accumulate information which could help Bank in establishing values.

- prices of recent land and housing sales
- information about government programs to assess value
- information about any individual or companies qualified to make real appraisals

Final Term Assist in developing procedures for valuing real estate collateral.

9.22 Purchase Agreements

Initial Term Investigate typical existing terms of purchase agreements and determine whether the existing conditions are an impediment to the Bank when they are presented as evidence of bona fide sales. Determine if they can be assigned to the Bank.

Interim Term Have Bank personnel compile typical sales agreement conditions.

Final Term Assist Bank to establish a list of acceptable and unacceptable terms and conditions to be included in the underwriting manual.

9.23 Pre-Sale Requirement

Initial Term In concert with the assignment on Purchase Agreements, the advisor should become familiar with the existing practices since proceeds from pre-sales are used for construction. A program should be developed to assure that the deposits from pre-sales are readily available when needed.

Interim Term Have Bank personnel investigate with a representative number of builders their experience in being able to obtain the deposits when required.

Final Term Assist Bank in setting pre-sale requirements and establishing a program which will assure the availability of deposits. One possible way would be to have all pre-sale deposits placed in interest-bearing accounts at the Bank.

9.24 Land Exchange and Building Rights

Initial Term Advisor should become familiar with these practices by interviewing builders and landowners. It would also be advisable to investigate this with lawyers. Lenders are not always in first position, and advisor should provide guidance as to how lender can best protect its lien.

Interim Term ---

Final Term Assist Bank to develop a policy for construction loans where there is a land exchange.

9.25 Training

Initial Term Basic underwriting of the project and evaluating the credit worthiness of a borrower should be stressed. Weekly workshops of one to two hours duration should be held with the three staff members of the main office construction loan department. The advisor should develop case problems to illustrate procedures.

Interim Term Develop case problems about typical underwriting problems which can be expected to confront the Bank. Case problems should be based entirely on the conditions existing in Bulgaria as understood by the advisor.

Final Term Conduct weekly workshops of two to three hours duration utilizing the case problems developed during the interim term.

9.26 Computer Capability

Initial Term Investigate the potential of Bank 's FISERF software.

Interim Term If FISERF is adequate, no action required during this term.

If the advisor feels other alternatives should be considered by the Bank, he should obtain helpful information on other programs.

If FISERF is not adequate, advisor should assist in selecting more adequate program.

Final Term Assist in implementing the FISERF system.

9.27 Loan Structuring

Initial Term Provide assistance as required for loans being underwritten.

Interim Term Monitor loans being originated from reports submitted weekly by the Bank.

Final Term Assist in structuring loans in compliance with new credit policy and underwriting procedures.

9.28 Market

Initial Term Research how to obtain information about:

- housing demand
 - types of units
 - sizes of units
- land availability
- cost of construction
- sales prices of recent land and house sales
- financing sources
- qualified builders

Interim Term Have Bank staff continue research

Final Term Compile information obtained into a data center using a computer system. Procedures should be established for continuing updates and increasing areas of knowledge.

9.29 Business Development

Initial Term Conduct workshops and discuss:

- sales objectives
- how to target prospective borrowers
- how to plan a sales call, including the objective to be obtained
- how to ask open-ended questions to maximize responses from prospect
- how to set up and maintain prospect files

Interim Term Develop case problems requiring demonstration sales calls in which Bank members will play a role.

Final Term Present at least two sessions using case problems developed during interim term.

9.30 Competitive Market

Initial Term Provide thirty-minute sessions on a regular basis to discuss elements of this process which can include the following:

- marketing of services
- pricing of products
 - interest rates
 - fees
- customer service
- Bank's cost of funds
- illustrations of typical practices used by American banks
 - promotion of new products
 - entertaining customers and prospects

Interim Term Develop strategies which could be used by Bank. Create illustrations which can be helpful during the final term.

Final Term Continue discussion started during initial term. Provide information created during interim term.

9.31 Staff Credibility

Ongoing Since the staff of the construction department is new, it will be essential to assist them in establishing credibility by producing high-quality underwriting memorandums, new business pipeline reports, and other management information, and in general increasing the unit's stature within the bank.

EXHIBIT A

REAL ESTATE CREDIT POLICY HOUSING DEVELOPMENT

CONTENTS

1. Loan Committee
2. Loan Approval Authority
3. Loan Types
4. Loan Amounts
5. Loan Terms
6. Loan Pricing
7. Security
8. Disbursements
9. Repayment
10. Appraisals
11. Equity Requirements
12. Credit Criteria
13. Loans to One Borrower
14. Personal Guarantees
15. Legal
16. Commitments
17. Documentation
18. Title
19. Insurance
20. Underwriting Procedures
21. Administration Procedures
22. Regulatory Compliance
23. Market Area
24. Market Concentration
25. Loan Type Concentration
26. Loan Production Objectives
27. Form of Request for Loan Approval
28. Management Reports
29. Loan Review
30. Project Inspectors

EXHIBIT B

UNDERWRITING MANUAL

1. UNDERWRITING
 - A. Project
 1. Land
 2. Site Development and Home Construction
 - a. Plans, Specifications and Costs Breakdown
 - b. Site, Location and Market
 - B. Repayment
 - C. Borrower
 - D. Guarantor
 - E. Contractors
2. LOAN APPROVAL REQUEST
3. LOAN COMMITTEE PRESENTATION
4. COMMITMENT
5. PRECEDENCE TO CLOSING
6. LOAN CLOSING
7. POST-CLOSING
8. EXHIBITS
 - A. Application
 - B. Application Register
 - C. Worksheet
 - D. Letter of Acknowledgment
 - E. Letter of Instruction to Inspecting Engineer
 - F. Letter of Instruction to Appraiser
 - G. Stage Draw Schedule
 - H. Financial Statements
 - I. Loan Presentation
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 - K. Letter of Commitment
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 - M. Mortgage
 - N. Loan Agreement

EXHIBIT C

LOAN ADMINISTRATION MANUAL

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2. Loan Commitment and Documentation
3. Legal Representation
4. Loan Closing
5. Post-Closing
 - A. Establishing and Maintaining Files
 - B. Monitoring Critical Dates
6. The Cost Breakdown and the Loan Budget
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 - A. Loan and Equity Funds
 - B. Progress Inspection
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 - D. Maintaining Budget Balance
 - E. Reallocating Budget Items
 - F. Adequacy of Loan Proceeds
 - G. Confirmation of Payments
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8. Construction Inspector
9. Interest
10. Loan Budget and Cost Control
11. Site Inspections and Meetings
12. Compliance to Terms and Conditions of Loan Documents
13. Regulating Housing Starts
14. Insurance and Taxes
15. Release of Homes from Loan
16. Governmental Approvals
17. Settlement Procedures
18. Environmental Issues
19. Accounting
20. Disposing of Documents
21. Loan Problems

EXHIBITS

- A. Loan Instruction Sheet
- B. Loan Budget
- C. Draw Schedule
- D. Application for Payment—Stage Draw
- E. Application for Payment—Percentage of Completion

- F. Letter of Instruction to Inspecting Engineer
- G. Construction Loan Ledger
- H. Commitment Report
- I. Payoff Forecast