Chapter 8
Mortgage Credit

8.1 Introduction

This chapter is designed to explain FHA’s underwriting criteria for determining the
creditworthiness of a Principal, i.e., the Principal’s capacity of credit, experience and financial
histories. It also covers determining the maximum insurable mortgage as well as other financial
requirements for issuing a Firm Commitment and closing under the different sections of the
National Housing Act.

Principals of the borrowing entity and of other entities participating in FHA multifamily mortgage
insurance programs must have a positive credit history demonstrating that they will honor their
legal, financial and contractual obligations. All Principals must be identified and analyzed with
respect to their creditworthiness. Regulatory standards established in the Code of Federal
Regulations (24 C.F.R.) Part 200 Subpart H Participation and Compliance Requirements
determine the appropriate review of previous participation in multifamily insured programs, based
upon past performance and other aspects of a Principal’s records.

In certain standards addressed in this chapter separate policy has been developed for Low Income
Housing Tax Credit projects and this policy is presented in Chapter 14. If apparent conflicts arise
between this Chapter and Chapter 14, Chapter 14 guidance will prevail in the underwriting of Tax
Credit Projects.

8.2 Borrower Types – Single Asset Borrower Entity

A. A single asset borrower entity is required for all multifamily FHA mortgage insurance projects.
The single asset borrower entity must be registered in the United States and in the State where
its corporate office is located. Natural Persons, Delaware Statutory Trusts, Maryland Business
Trusts, foreign entities, and Tenants in Common are not eligible single asset borrower entities,
although such entities may have ownership interests in the single asset entity borrower.
Acceptable forms of single asset entities that may participate in FHA insured transactions include the following:

1. General Partnership (GP); An ownership structure may have two or more general partners. A written partnership agreement may be accepted in lieu of a state registration.
2. Limited Partnership (LP); A limited partnership must have at least one GP and at least one LP and must also conform to the laws of the jurisdiction in which it was established.
3. Corporation, C Corporation, or S Corporation with shareholder owners and corporate officers and directors who may or may not be shareholders.
4. Limited Liability Company (LLC) composed of members, with one or more managing members and one or more investor members.
5. Trust with beneficiaries and one or more trustees (when the borrower is a trust, the duration of the trust must be equal to or longer than the term on the FHA Note).
7. Any other public or private single asset borrower entity.
8. Any combination of acceptable ownership forms can be used to establish a joint venture for the purpose of jointly sharing the risks and the rewards and contributing the appropriate knowledge, skills or assets necessary to a successfully developed project. However, the borrower must always be a single asset entity.

### 8.3 Reviewing Principals and Other Parties in Control

The individual(s) and entity(ies) who exercise operational and financial control over a project are subject to a mortgage credit review. This review includes creditworthiness review and a review of previous participation of such individual(s) and entity(ies) in federal programs.

A. Determining Principals and Who is in Control.

The term Principal refers to individual(s) and entity(ies) who exercise operational and/or financial control over a project. MAP Underwriters will consider a Principal(s) in three contexts: (1) individual(s) or entity(ies) who possess financial and/or legal control of the borrower, thereby requiring financial and credit analysis; (2) person(s) or entity(ies) who will execute Section 50 of the HUD Regulatory Agreement and also require financial and credit analysis; and (3) individual(s) or entity(ies) who must disclose for Previous Participation Certification review.

“Principals” may include any of the following:
1. “Active Principals” are individuals or entities who singly or with others direct and control the Borrower and are responsible for the Borrower’s ability to execute any and all actions for the benefit of the project, regardless of the extent of their equity interest. Under HUD’s Processing Guide, a Principal is any entity that has an ownership interest of 25% in the project to be insured, which is reduced to 10% for corporations. However, and regardless of the percentage of ownership interest, principals are subject to both a financial underwriting review and a previous participation review if they possess a substantial financial interest or have decision making authority in the borrower.

   a. Active principals of a borrowing entity that possess a substantial financial interest and/or have decision making authority are subject to a credit and financial underwriting review. A substantial financial interest is an interest that would create an ability by the investor to direct the operations of the borrower, or influence, either directly or indirectly, the decision-making authority of the managing member or general partner. The MAP Lender must determine whether a principal is Active by reviewing the organizational chart and identifying the various partners and their relation to the borrowing entity and to each other.

2. “Passive Principals” are persons or entities who singly or with others have limited or no decision-making power or control over the Borrower but who have an ownership interest of 25% or more (10% for corporations) in the Borrower. Language in the Partnership Agreement or Organizational Documents should evidence that the Passive Principal has no operational or decision-making authority.

3. “Borrower” is the single asset borrower entity.

4. Foreign National individual and/or business entity. [See Section 8.3.E]

5. A Special Limited Partner Entity (SLP) [This principal type applies only to LIHTC transactions]. This permits the admission of a “Special Limited Partner” in case of default by or other failure of the initial General Partner. Provision of Notice to the Investor by HUD and pre-approval of a Special Limited Partner can be achieved through a “Rider to the Security Agreement for LIHTC Properties” available at:


   In addition, instructions for the use of this Rider are provided at

   When passive partners are replaced after final endorsement, a modified Transfer of Physical Assets (“TPA”) is required.
The Production Office will process submissions for Pre-Approval of the Special Limited Partner Entity, which must occur at or before Initial Endorsement or Initial/Final Endorsement; otherwise the SLP shall be treated as a passive investor.

6. Requirements for General Contractors (GC): A General Contractor will be treated as a principal if it has an ownership interest in the project of over 10%.

7. A Principal may be a public or private entity, whether an individual or business, proposing to participate in a project as an owner or general contractor. Under certain conditions specified in 8.3.E, the individual or entity may also be a foreign national. A Principal maintains significant decision-making authority regarding an FHA-insured loan transaction, and/or retains the significant percentage of ownership in a single asset borrower entity. The Principal’s role can involve active participation in directing the activities and affairs of the borrower entity or passive participation when an ownership interest has been acquired in the entity. All types of Principals are subject to financial and credit disclosure and underwriting.

B. Underwriting Active Principals and Those with Operational and Financial Control.

1. Principals must have positive experience and qualifications in developing, owning or building multifamily properties reasonably comparable in kind and scale to the subject of the proposed transaction. Comparable in kind and scale means: (a) similar in physical size (e.g. number of units) and building type and uses (e.g., low rise, high rise, commercial spaces); (b) similar financially (e.g. revenues, expenses, size of mortgage, required liquidity); (c) similar operationally (e.g. target markets/tenant population, elderly, subsidized or affordable); and (d) similar in kind of transaction purpose (e.g. acquisition, re-positioning/turn-around, rehabilitation, new construction).

Underwriting a Principal requires their financial and credit disclosure including: (1) a designated person and an entity to sign Section 50 of the Regulatory Agreement, (2) individual or entity credit reports, (3) individual or entity financial statements, HUD forms, documents and Schedule of Real Estate Owned (REO)/debt schedules, (4) Internet searches (e.g. SAM.gov (System for Award Management) and searches of debarment and delinquencies (i.e. MDDR Multifamily Delinquency and Default Report), OFAC (Office of Foreign Assets Control) and any other relevant databases, and (5) pre-approval in cases where their total HUD-insured debt is greater than $500,000,000.

2. Credit and Financial Underwriting Review Required on Other Principals (individuals and entities):
a. Investors (passive principals) that have exceeded the $500,000,000 threshold or wish to avoid exceeding that threshold and wish to invest in a project as a passive investor.

b. An investor (passive principal) whom the borrower relies upon for both their financial strength and cash requirement contribution.

3. Principal Types Not Subject to Credit Review:

a. Investor entities with limited liability benefiting from tax credits, including but not limited to low-income housing tax credits pursuant to Section 42 of Title 26 of the United States Code, whether such investors are syndicators, direct investors or investors in such syndicators and/or investors.

b. Parties whose sole interest is that of a purchaser or owner of less than five individual unit(s) in the same condominium or cooperative development; (ii) parties whose sole interest is that of a tenant in not more than two units in an FHA mortgaged insured property.

c. Public Housing Agencies (PHAs) where the PHA is acting in its capacity as a PHA owning and/or operating public housing. However, PHAs are expected to form single asset entities to hold properties financed with FHA mortgage insurance.

d. Passive Principals who have limited or no decision-making power or control over the ownership entity. A passive Principal’s financial or other obligations to the borrower and the property may be fixed and defined before endorsement, with the borrower or its Principals having limited or no power to compel a passive Principal to increase its obligations. A passive Principal may have limited power singly or with others, or no power to remove, replace or diminish the powers, or alter the compensation of Principals. As used here “limited” means that the rights of a passive Principal to exert control or effect decisions that are defined in organizational documents and are limited to specific actions intended to remedy negligence or default by a Principal, or to protect the passive Principal from loss due to a default or failure of performance by the borrower.

e. Shell Entities that to not take actions themselves but only serve as legal vehicles through which the partners, members or owners of such entity take actions.

4. Organizational Charts

An organizational chart of the single asset borrower entity must be submitted with each application. Organizational charts are a visual/graphical disclosure of the participants that constitute the ownership structure, which facilitate HUD’s loan underwriting and the separate process of a Previous Participation review.
Acceptable organizational charts for the typical HUD project have the following attributes:

a. Depicts all tiers of the ownership structure, starting with the single asset borrower entity and concluding with the ultimate source of equity. Ultimate sources of equity are often an individual, trust, or a widely held corporation.

b. Displays all intermediate entities such as pass-through entities, which results in a full disclosure of all participants. Controlling and limited ownerships are depicted as separate intermediate individuals/entities.

c. Displays each entity’s legal name, type (e.g. LLC or LP) and ownership percentage of its parent. Ownership percentages reconcile to 100% for entities (including intermediate entities).

d. Lists at least one natural person. Tax credit investors and limited investors need not always trace to a natural person.

e. Denotes individuals or entities that will sign Section 50 of the HUD regulatory agreement (i.e. using an asterisk and footnote or other means).

f. Discloses if any entity is publicly held, its exchange, and ticker symbol (e.g. “XYZ Corp. (NYSE: XYZ)”)

g. Consolidates or groups widely held interests to achieve conciseness. For example, a group may be labeled on the organizational chart (e.g. “10 Additional Limited Partners”), along with aggregate ownership percentage.

h. Provides additional disclosure in narrative form or a separate organizational chart, avoiding unnecessary visual complexity of the borrower’s organizational chart.

C. Regulatory and Processing Requirements for Previous Participation Certification Review.

Certain Principals are subject to a previous participation certification review as set forth in 24 C.F.R. Subpart H 200.220, and the same may be amended from time to time. This review is in addition to any underwriting considerations or review. Those individuals and entities subject to previous participation certification review in accordance with 24 C.F.R. Subpart H 200.212 must submit form HUD-2530 or any successor form or electronically through the Active Partners Performance System (APPS) or any successor electronic system. Individuals and entities that are excluded from underwriting review are also excluded from previous participation review. Guidance with respect to previous participation certification review may be updated from time to time through Mortgagee Letters or other appropriate means.

Active Principals must possess and disclose social security numbers (SSN) and employer identification numbers (EIN). This is required by 24 C.F.R. 5.216(c), (d) & (f) for applicants and participants under 24 C.F.R. 200.6 and 24 C.F.R. 200.1101.

1. Controlling Participants for Previous Participation Review Purposes. Controlling Participants are those entities and individuals (i) serving as a Specified Capacity with respect to a Covered Project and (ii) the entities and individuals in control of the
Specified Capacities. At least one natural person must be identified as a Controlling Participant for each Specified Capacity.

For any multifamily project, with an insured or proposed FHA insured mortgage under the National Housing Act, (a “Covered Project”), an individual or entity serving in any of the following capacities is also considered to be a “Participant” for purposes of this previous participation section. Participants are natural persons (individual) or entities who may or may not be an Active and/or Passive Principal but who are required to file for previous participation certification review, i.e. Form HUD-2530 or APPS. Specified Capacities are:

a. The borrower entity,

b. The owner, if different than the borrower entity, e.g. in a transfer of physical assets (TPA) or change in role,

c. The management agent,

d. The general contractor, and/or

e. The foreign national (individual and/or business entity).

The foreign national Active Principal, who is an individual, must possess and provide an SSN, and a business entity must possess and provide its EIN. An Individual Tax Identification Number (ITIN) cannot to be used in place of the SSN or EIN for a foreign national Active Principal. HUD will not require a foreign national Passive Principal to provide an SSN or EIN. An SSN or EIN is required if the Passive Principal’s role later changes to Active Principal.

In addition to the entities named above, an individual or entity determined by HUD to have control over the day-to-day financial or operational decisions of an FHA-insured property shall also make a previous participation certification review submission. If a Controlling Participant is an entity, the submission must include those individuals who exercise the day-to-day financial or operational control for that entity.

2. The previous participation certification procedure assesses the experience of applicants with FHA-HUD insured mortgage programs and with the United States Department of Agriculture Rural Development (USDA-RD) multifamily programs. All submissions must include a previous participation certification and may be made via the Active Partners Performance System (APPS), or paper Form HUD-2530. Submission of the previous participation certification review or Form HUD-2530 is not a substitute for processing the application for project acceptability, credit capacity, or competency. Paper submissions are acceptable if the Participants are having trouble with the APPS
access. All Participants must certify and sign the certificate personally as to their individual record and are responsible for its timely filing with the Regional Center having jurisdiction over the project. Any Participant experiencing trouble with or wants to learn more about APPS, to register, access the user guide, or use the tutorial can visit HUD’s website by clicking the following link:

3. A Previous Participation Certification is required from the following Principal types:

a. Tax credit syndicators or investors with an identity of interest in the general partner or managing member.

b. For-profit entities; officers of the entity’s board of directors (BOD); officers and the executive management team of the entity (such as the President, Chief Executive Officer etc.), if different than the officers of the BOD; or any other individuals determined by HUD to control the entity.

c. Nonprofit borrowing entities, including the:
   1. Executive Director or another manager or officer of the non-profit corporation. Non-profit board members who do not exercise control over the corporation in another capacity (for example, as Executive Director or other manager or officer of the non-profit corporation) are excluded from filing for the previous participation review requirement.

d. Special Limited Partner (SLP) Entity in a LIHTC transaction seeking pre-approval.

e. Investors (passive principal) that have exceeded the $500 million threshold or investors who wish to avoid exceeding that threshold and want to invest in a project as a passive investor with less than a 25% interest (10% for corporations) so as not to trigger the threshold.

f. An investor (passive principal) from whom the borrower relies upon for both financial strength and cash requirement contribution but still maintains an ownership interest of less than 25% (10% for corporations).

g. Foreign nationals who are Controlling Participants (as defined in 24 C.F.Rs. 200.212 & 200.216 and Housing N-2016-15) for the Specified Capacity (owner, borrower, management agent, general contractor, as set forth in the Regulations and Housing Notice) are required to register in the Business Partner Registration System of APPS (Active Partners Performance System). Participants will either prepare and submit the electronic filing of the Previous Participation Certification (Form HUD-2530) through APPS or submit a non-electronic (paper) filing of the Form HUD-2530. The Controlling Participant must file using either an SSN or EIN. Passive Principals are not required to file a Previous Participation Certification. See Housing Notice H 2016-15 and 24 CFR Part 200, Subpart H (2018) for more detailed information.
4. A previous participation certification (form HUD-2530 or APPS) is not required on the following situations or roles:

a) Individuals who provide a certification in one capacity need not provide a separate duplicate certification.
   When a corporation (for-profit or nonprofit) is a Principal, all its officers, directors and principal stockholders need not individually sign, certify nor file the certificate when they all have the same record. When their previous participation records are identical the officer authorized to sign for the corporation will list on the certificate the full names for all such principals connected with the corporation who do not elect to sign. Those principals who have a separate participation record outside that of their corporation must certify, sign and file. The objective is full disclosure.

b) Attorneys and architects with only an arms-length fee arrangement for services.

c) Sub-contractors.

d) Minor corporate officers who do not exercise control over an entity or who have no significant involvement in a project, as determined by HUD, need not complete a previous participation submission.

e) Persons or entities with passive ownership interests less than 25% (10% if a corporation) and officers and directors of corporations which are passive principals (e.g. shell entities like qualified opportunity investment funds).

f) Parties whose sole interest is that of purchaser or owner of less than five individual unit(s) in the same condominium or cooperative development; and parties whose sole interest is that of a resident.

g) Tax Credit investors, Passive Investor Principals, Syndicators and direct investor entities in Low-Income Housing Tax Credits, Historic Tax Credits, New Markets Tax Credits or other tax credits (if HUD determines such credits are substantially similar to the listed tax credits) are excluded unless such entities exercise day-to-day control or seek other involvement that would trigger the need for previous participation review. For these passive investors, HUD requires the “Identification and Certification of Limited Liability Investor Entities (ICLLIE),”. The certification is found in Appendix 8H.

If during the underwriting it is found that an entity has triggered the need for a previous participation review because it will exercise day-to-day control or other involvement exists that would trigger a review, or the entity does not want to provide an ICLLIE, they must submit in place of the required certifications the following items: organizational documents, HUD 92013-SUPP, a credit authorization, EIN verification, and credit report.
h) Public Housing Agencies/Authorities, who are subject to separate treatment for projects redeveloped under the RAD program; and

i) Brokers whose services are limited to referring the loan to a lender and presenting information on behalf of the borrower.

j) A Qualified Opportunity Zone Fund that has invested in an insured project structured as a shell entity need not file; however, the fund and its participants must be identified on the organizational chart.

D. Nonprofit Principals.

1. Nonprofit Principal is understood to mean “the Single Asset Entity (SAE) borrower and its Board of Directors” (BODs). The BODs acting as officers and/or member/directors who do not exercise control over the corporation in another capacity are excluded from filing. However, an Executive Director or other managing officer of the nonprofit corporation are considered Controlling Participants.

2. Nonprofit entities and sponsoring parent organizations that are Principals with control and exercise day-to-day financial or operational control of the SAE must demonstrate financial strength, credit history, experience and capacity Executive officers must provide resumes evidencing experience commensurate with the requirements of the project. Generally, analysis of personal financial information, including credit reports, HUD-92013-SUPP forms, and financial statements including verifications of deposit or available liquidity are not required of board members or officers of the nonprofit. Any Officers that exert management control and other executive management including the Executive Director of the nonprofit corporation will only provide the previous participation certification.

3. Where a nonprofit is not a Principal but proposes a role such as property manager, service provider, or an intermediary with a local community or constituency, the nonprofit must demonstrate experience, management ability and financial capacity to execute the proposed services. For its role as property manager, the non-profit entity must provide the previous participation certification.

4. “Sponsor” is an informal term use for persons or entities who may do one or more of the following: locate and control the site; assemble the development team, provide financial assistance to the project or provide development experience and expertise to the project in ways other than as a paid consultant. The Sponsor is not the SAE though they may also act as a Principal in the ownership entity.
E. Foreign National Participation in FHA-Insured Multifamily Programs.

Foreign national individuals and business entities may participate as either Active or Passive Principals in FHA-insured Multifamily programs (as defined in Section 8.3 of the MAP Guide and as clarified below The formed single-asset-entity borrower must be registered in the United States and in the State where its corporate office is located. At least one Principal with operational decision-making authority must be a United States citizen or a foreign national who is a lawful permanent resident of the United States, having an immigration status granted by the United States government that enables that Principal to exercise operational decision-making authority. It is the MAP Lender’s responsibility to confirm that foreign national entities are properly identified as Active or Passive Principals. This analysis is to ensure that Passive Principals have no decision-making authority, or operational control, and do not represent a financial or legal risk to HUD.

As required under Section 8.3 above, each foreign national individual or foreign national controlled private entity that is an Active or Passive Principal must be listed on the borrower entity’s organizational chart.

2. Background Evaluations of Foreign National Principals.

In addition to the existing requirements applicable to all Active and Passive Principals under Section 8.3 above, the MAP Lender must perform a thorough and independent background evaluation for all foreign national Principals including:

   a. A review of organizational documents, personal resumes, history of past business relationships and litigation, i.e. foreign and domestic criminal and civil, and

   b. Research of the foreign national Principal on the following internet and database systems: SAM.gov (System for Award Management; Office of Foreign Asset Control (OFAC) and the MDDR (Multifamily Delinquency and Default Reporting). The analysis of a foreign national business entity is conducted at the business entity level in addition to the executive who is authorized to execute actions of the entity.
Based upon the content of this background evaluation, HUD may require additional information and/or an investigation to better assess the foreign national Principal in terms of risk to HUD. The MAP Lender will summarize the results of their background evaluation from the legal risk and the business relationships in the MAP Lender’s Underwriter Narrative.

3. Domestic Principals

A Domestic Principal is an individual that acts on behalf of the partnership in cases where the remaining principals in the partnership are Passive foreign nationals. Similar to an Active Principal, Domestic Principals with operational decision-making authority must be a United States citizen who is a lawful permanent resident of the United States. This authority to act on behalf of the borrower presumes that the Domestic Principal has similar credit and financial strength and real estate development experience with those he/she is representing, such as an executive level officer (if employed by a real estate development organization). The MAP Lender has the responsibility to determine that the Domestic Principal has significant liquid assets and net worth (e.g., 3-5% of the proposed loan amount) that are commensurate with the level of financial obligation of the loan being insured, notwithstanding the requirement for the other Active (or Passive) Principals to provide necessary equity. The Domestic Principal should also evidence a high level of experience in similar real estate projects to that being proposed.

The MAP Lender must conduct a thorough underwriting of the Domestic Principal, focusing on the relationship of the Domestic Principal to the foreign national principal/entity, in the single asset entity. This investigation should include any past partnerships and joint ventures, the length of time that the parties have known or done business with each other, and any financial or legal obligations created by one to the other.


E-2 Treaty Investors are not eligible as Active Principals or Domestic Principals, given their nonimmigrant classification and temporary status (subject to renewal every two years: https://www.uscis.gov/working-united-states/temporary-workers/e-2-treaty-investors). Their short-term status conflicts with the need for longer term operational decision-making authority and stability of the foreign national Active and Domestic Principals within single asset borrower entities due to the lengthy maturity terms of FHA-insured Multifamily loans.
F. Definition of Principal for Regulatory Agreement Provision Section 50.

1. For privately held entities: The provision generally requires two signatures for project sponsors. In most cases, HUD, upon the lender’s recommendation, shall approve an individual signatory to sign in his or her individual capacity and the project parent/spONSor entity to sign in a corporate capacity. In any specific deal, underwriting may conclude that an entity with the requisite control and involvement or interest in the Project that possesses a positive credit history and adequate financial strength relative to the size of the loan may serve in the capacity required by Section 50. In some circumstances, particularly involving large, capitalized, and experienced corporate entities with complex corporate organizational structures, the underwriting may not reveal any apparent individual to reasonably serve in the required capacity, whereas the parent/spONSor entity itself may possess such necessary characteristics to act as the sole necessary signatory.

The lender may consider whether the entity has been approved as an appropriate signatory to provisions similar to Section 50 in a recent Government Sponsored Enterprise (GSE) transaction. A GSE transaction means any Fannie Mae DUS or Risk Sharing or Freddie Mac loan program, in which they have approved the signatory on their comparable carve out provisions. We will also consider the Federal Home Loan Bank as a GSE, if they also have similar approval. The GSE-approved entity may be an appropriate sole signatory for Section 50 if the entity has positive credit history and adequate financial strength. A copy of relevant excerpts from the recently closed transactions would evidence such GSE approval.

2. For publicly traded corporations, REITs (Real Estate Investment Trust), or nonprofit borrower: The parent/sponsor entity itself is acceptable as the sole signatory. For such entities, any individual signing on behalf of the corporate entity does not sign in an individual capacity, but to bind the parent/sponsor. No personal liability will be claimed against the individuals signing in such a capacity.

3. For nonprofit borrowers, the parent or other Principal must be named as the signatory for Section 50. In the event the parent or other Principal is not the entity, the nonprofit Single Asset Entity is the signatory named in Section 50. The MAP Underwriter’s Narrative should contain a brief explanation as to the reason why the nonprofit entity is named as the signatory.

4. For any corporate entities required to execute Section 50: An officer or entity or other person authorized to bind the company in connection with the proposed transaction may sign.
5. The following prohibitions relate to Section 50:
   a. Insertions of “or successors” language to the identification of signatories is not allowed. The Regulatory Agreement can and should be amended when there is a new individual who is responsible for the provisions of Section 50.
   b. Riders to the regulatory agreement that attempt to limit a signatory’s liability are not allowed.
   c. Section 50 may not be omitted simply because a currently insured project has been processed as a Section 223(a)(7).

6. The Domestic Principal or foreign national Active Principal who is a lawful permanent resident of the U.S. may each sign Section 50 of the Regulatory Agreement in his or her individual capacity. A foreign national Active Principal Section 50 signatory must either remain a lawful permanent resident of the U.S. for the life of the loan or be replaced with HUD’s prior written approval, a U.S. citizen or lawful permanent resident of the U.S.

7. The lender is responsible for the mortgage credit review of the parent/sponsor entity and to identify and verify the identity of the signatory of Section 50 of the Regulatory Agreement. The signatory will be identified in the Firm Commitment (or in a letter Amendment to the Firm Commitment).

8.4 Investigating Credit and Character

The MAP Lender’s underwriter is responsible for analysis and review of the mortgage credit exhibits, identifying credit issues and/or resolving discrepancies in order to determine that the Borrower and the Principals have demonstrated: (a) both the willingness and the ability to pay creditors in accordance with agreed terms, (b) the ability to deliver timely and satisfactory performance of contractual or business obligations, and (c) the mitigation of litigation risks by honoring prior loan obligations (especially during adverse market/financial conditions).

A. Use of Credit Reports and Credit Investigation.

1. Credit reports or credit histories are a means of validating and cross-checking information received from the Borrower and Principals in financial statements and in application exhibits. Credit reports give a picture of payment history and financial interactions with creditors. The lender must reconcile any contradictions with a summary statement.

2. A commercial credit report for a business or a residential mortgage credit report (RMCR) for individuals must be current within 60 days of the application acceptance date, and HUD may require updated reports during processing. Merged credit reports from the three major
credit bureaus are acceptable, but compiled infill reports are not acceptable. Infill reports
have the potential of containing select or less reporting rather than the full reporting as in
a single credit report.

3. For Principals who are individuals, credit reports are needed for the individual and for that
individual’s other business concerns (i.e. ownership of property management firm, general
contracting or subcontracting firm, or land or property development entities, etc.). The
lender should randomly select an overall 10% or more of these other business ventures or
property operating companies for credit review for the individual and its other business
concerns. The report should contain information on pending judgment(s), legal actions
and bankruptcy claims.

4. The general contractor’s credit reports are required on the business entity/firm, and its
operating affiliates, if any. The Lender must provide credit reports for Principal(s) of the
general contractor if the financial capacity and track record of the general contractor entity
is deemed insufficient to assess a credit risk.

B. Lender’s Review of the Credit Report. The lender is required to do all of the following:

1. Compare all information obtained from credit reports and histories to the financial
statements provided by the relevant borrower or principal(s). Resolve or explain
contradictory information.

2. Make reasonable inquiries to determine if the applicant or any principal is in default on any type
of federal debt including direct loans, HUD insured loans, student loans, Small Business
Administration loans or judgment liens against the property.

3. Investigate any adverse credit information that appears on the credit report and obtain a
written explanation of any late payments, actions, judgments or derogatory information.

C. Delinquent Federal Debt, Judgments and Pending Litigation.

1. When delinquent federal debt is identified, the lender must include as part of the required
application exhibits:

   a. A detailed written explanation from any applicant or principal with a prior federal default
      or claim, or whose credit report and financial statements contain conflicting or adverse
      information.
b. A letter from the affected agency, on agency letterhead and signed by an officer, stating the delinquent federal debt is current or satisfactory arrangements for repayments have been made; and  
c. The lender’s reason(s) for recommendation of the applicant, which may be included in the lender underwriter’s review and recommendation.

2. The lender shall also investigate any other serious adverse information, including but not limited to bankruptcies, defaults on real estate mortgages, tax liens, foreclosures or deeds-in-lieu of foreclosures, judgments and pending litigation.

D. Trade and Credit References.

1. HUD requires a completed Fannie Mae Form 1006, Request for Verification of Deposit or bank statements (including a three month average balance on the VOD or three months of consecutive bank statements) to verify Borrower’s/Principal’s liquid assets for each bank account listed in the credit report. Deposits and/or marketable securities of the Principal must be verified and examined in consideration of the Principal’s liquid assets reported on financial statements. Both sources should be reasonably consistent, and any significant differences should be explained. When a Principal’s financial statements show real estate owned and other mortgage debt, the credit references must include a sampling of the Principal’s mortgage payment histories and must confirm the character, business acumen, expertise and timeliness of the Principal in meeting their business obligations.

2. A credit report with sufficient data may be used in place of trade references.

3. Written inquiries of trade references should include a copy of the certification authorizing the release of credit information.

E. Rejection Because of Unacceptable Character and Credit.

1. The lender’s professional judgment is required in approving or rejecting Principals on the basis of character and credit.

2. The Principal should be a credit rejection if:
   a. The Principal has a history of late payment or non-payment of creditors or has defaulted on debt without making reasonable attempts to remedy or cure the default. The lender’s underwriter may not recommend approval of a Principal with a history of default without contacting the defaulted lender to determine the circumstances surrounding the default with a summary of these discussions included in the lender’s narrative.
b. Delinquent federal debt has not been resolved or satisfactory arrangements made for repayment.

c. There are judgments or actions against the party, which:

(1) Could significantly impact the financial position of the individual/ firm or corporation, or
(2) Result in a determination that the individual/firm or corporation is an unacceptable credit risk.

d. The Principal is insolvent or is the subject of a pending bankruptcy or insolvency proceeding at the time of application, issuance of the Firm Commitment, or at the time of loan closing.

e. Active Principals are currently flagged in the Active Partners Performance System (APPS) for FHA-insured mortgage defaults or other financial improprieties as determined by HUD.

3. The MAP Lender is responsible for amending or withdrawing the Commitment application if there is a material adverse change in the Borrower’s credit after application submission.

4. Principals with repaired credit may be considered for approval provided that a positive credit history has been established and sustained for a period of time encompassing both favorable and unfavorable economic conditions and that the principal has during that time been engaged in financial transactions and/or business enterprise comparable in scale to the proposed insured mortgage transaction. It is unlikely that this period would be less than 7 years.

5. Departmental Enforcement Center (DEC) Referrals. The MAP lender should discuss with the borrower and its Principals to ensure that any matters pending with the DEC relating to the borrower, the management agent and/or the Project have been resolved.

8.5 Evaluating Financial Capacity of the Borrower Entity, Principal(s), and General Contractor - Financial Statement Analysis

Financial statements are reviewed for the borrower and Principals to determine that the borrower, and/or the Principals have the financial capacity to own and operate the property. For construction proposals, an analysis of financial statements is used to determine whether the owner and the general contractor have the singular ability to deliver the project. Financial
analysis is performed on Active Principals as identified in the borrower entity’s organizational structure. The Lender’s Underwriter must determine which Principals have control of the single asset entity and the property; and review their financial statements along with any financial schedules to assess the Principal’s financial stability and assess any potential risk to FHA. Also, the Underwriter must analyze and disclose to HUD as part of their recommendation any financial interests that do not rise to the level of Principal, but nevertheless have a material impact on the creditworthiness of the proposed Borrower or its Principals.

These determinations are based on:

a. Past financial condition,
b. Present liquidity, and
c. Projected future financial capacity.

A. Submission of Financial Statements - New Construction.

The Active Principals and the general contractor must submit with the loan application current financial statements to include a balance sheet, income and expense statement, supporting schedules a REO schedule history and the schedule of mortgage debt. Individuals will submit a Personal Financial and Credit Statement, Form HUD-92417 (or an acceptable form of financial statement e.g. balance sheet that contains a certification and criminal warning statement.) and if applicable, an REO schedule and schedule of mortgage debt. The general contractor must submit a REO schedule if it has a significant financial interest or contribution or has a role to direct project operations. A non-identity of interest general contractor with only a nominal equity interest need not submit REO. See Appendix 8A for detailed requirements.

The financial analysis is used to determine the amounts available for investment in the project by performing an analysis of working capital. Working capital is the difference between current assets and current liabilities and is the cash or liquidity that exists to purchase assets, pay off debt and make up deficits from operations or fund new activities or projects. The financial analysis also determines which non-pledged assets can be readily used as collateral or pledged as security to obtain cash. See Appendix 8B for instructions on how to correctly analyze financial statements when determining the financial capability of the Active Principal, sponsor, general contractor and/or Manager of an LLC.

B. Existing Project Financial Statements.

1. The borrower entity must submit:
   a. The last 3 fiscal years of unaudited financial statements on the project and, if more than 3 months have elapsed since the closing date of the most recent financial statements, a year-to-date balance sheet and operating statement. If three years have
not elapsed from certificate of occupancy to application submission, a trailing twelve
or year-to-date balance sheet and operating statement is required.
b. Copies of the most recent insurance and property tax bills.

Three years of financial statements are not reviewed, audited, compiled or
consolidated by a CPA.

2. If the 3 years of financial statements are audited by an independent CPA or IPA, no further
review is needed to validate the statements.

3. For refinance applications, if the financial statements are not audited, submit a CPA or IPA
“reviewed” statement for the last complete fiscal year. “Audited,” and “Reviewed,” are
defined professional standards for reports understood by CPAs. The intent of this
requirement is to obtain an independent (non-identity of interest) professional review of
the financial statements certified by the Owner.

4. Year-to-date financial statements may also require CPA or IPA review, or if the project
has a history of stabilized occupancy and financial performance, a borrower-certified year-
to-date statements may also be acceptable. Examples of when year-to-date financial
statements might require CPA or IPA review include factors such as: 1) period covered is
all but the last month of the fiscal year, 2) there is a soft market or case-specific risk factors,
and 3) the project is applying under the three-year rule waiver and has just reached
sustaining occupancy. For this purpose, “CPA reviewed” means a review by a Certified
Public Accountant and “IPA reviewed” means a review by an Independent Public
Accountant of the records and statements of the Borrower specifically including:

a. The property’s financial statement(s) for the period.
b. Rent rolls for each month of the period.
c. Bank statements for not less than the last 6 months of the period.
d. The Borrower’s income tax return for the last three-years; and
e. Reconciliations of rent rolls to financial statements and financial statements to
normalized operations, cash receipts and tax returns.

5. There may be circumstances beyond the Borrower’s control where the required financial
statements are not available because of loss by fire, arson, theft, flood event etc.

a. The Borrower must submit:
   1) Evidence satisfactory to the lender that the financial statements are not
      obtainable; and
   2) Project financial statements that are available including an owner-certified
      balance sheet and operating statement.
b. Lender’s case file must contain a statement from the Borrower that explains why all the required records are not obtainable and a memorandum from the underwriter to the Regional or Satellite Office Director stating that he/she has evaluated the borrower’s statement and agrees that the information is not available.

6. Owner-certified financial statement or owner-certified balance sheet and operating statement must include the entire certification and criminal warning found in Appendix 8A.1.b(1), (2), and (3).

7. Past Due Payables and Past Due Project Liabilities. Past due accounts payable and outstanding liabilities for project operating expenses must be cleared and released, or otherwise fully resolved, before or at Initial Closing. Examples of such items include deferred management fees, over-due utility bills or real estate taxes, and trade payables. These items are not to be included in the eligible debt basis in the calculation of the cost of refinance/acquisition.

8. If the transaction does not involve a Transfer of Physical Assets (TPA), and if approved by the Regional Center Director, surplus cash notes may be established for payables owed to a related entity. Accounts payable and outstanding liabilities that are not past due do not need to be resolved at or before closing.

9. Applications for refinancing of newly built or substantially rehabilitated properties

C. Review of Financial Statements and Other Documents

1. A current financial statement must be no more than 3 months old when Form HUD-92013 is submitted to the lender for Firm Commitment review. The lender must determine financial stability and financial strength, unless the Active Principal and/or the Sponsor are a public company with an investment grade credit rating.

2. Exceptions:

   a. The credit investigation or other circumstances may warrant more current financial statements.

      1) Assess the adequacy of each Active Principal’s liquidity and its ability to provide immediate and ongoing support to the property, as well as to any asset that is in financial difficulty. For those properties in financial difficulty, consider that property’s strength as well as liquidity sources outside the property, such as the Principals and/or the Sponsor, as applicable. The lender
must look for likely future events that may drain cash resources from the Principals, (i.e. loans held by an Active Principal that mature within five years).

2) The lender may include other sources of Principal cash flow in the analysis, if the source and stability of the cash flow has been verified by reviewing historical tax returns. It is not necessary to include interest income from notes receivable, real estate investment income, dividend income and Principal salaries in the analysis.

b. Audited or reviewed financial statements prepared by a CPA or IPA may be up to 1 year old. The audited or reviewed statements must be supplemented with year-to-date financial statements and supporting documentation, which may be management agent-prepared if more than 6 months have elapsed since the closing date of the audited statement.

3. A Borrower that is fully funded with adequate capital in an account in the name of the Borrower must still provide financial statements for the Active Principals.

4. Make a working capital determination for the Borrower, its Active Principals and the general contractor based upon a review of their financial statements and projects currently planned or in the development process/construction stage as applicable. Adjust the net working capital for the effect of contingent liabilities, pledged financial requirements and the financial needs of other projects in the planning stage or under construction, adjusted by the percentage of completion.

5. Net worth in lieu of working capital (hypothecation of fixed assets) occurs when existing assets can secure loans or lines of credit to cover the project’s financial requirements and such loans or lines of credit are confirmed as being available. In this case, the underwriter should recommend approval based on “true net worth” rather than on working capital; and require the Active Principal to provide a commitment letter from a lending institution that states:

a. The rate, amount, term and conditions, if any, of the loan or line of credit that the lending institution is willing to provide. (See 8.5.D.4 below)

b. The date by which the commitment letter must be exercised. The date must extend at least to the anticipated date for initial endorsement.

c. The party that will be responsible for repayment of the loan or line of credit, if the commitment is exercised.

1) Repayment may not be an obligation of the borrower entity.

2) A certification from the lender affirming that the lending institution will not make any claim against the mortgaged property, mortgage proceeds, any
reserve or deposit required by HUD, or against the rents or other income from the mortgaged property for payment of the loan or line of credit. This certification must contain the criminal certification found in Appendix 8A.

6. Funds provided by a parent company/Sponsor or affiliate of the Principals will require a certification from the Board of Directors or authorized agent that specifies the funds the parent company/Sponsor or affiliate will commit. Establish the availability of funds from the parent company/affiliate. Consider whether:

a. Individual corporations have any excess operating capital (e.g. restricted assets);

b. Laws under which they are incorporated or their banks permit:
   1) Withdrawals, loans or advances to owners or sponsors.
   2) Stock investment in affiliated corporations.
   3) Guarantee of debts of associated corporations.

D. Letters and Lines of Credit.

1. Letters of intent and letters of credit cannot be used to establish financial capability. At initial endorsement, however, letters of credit may be substituted for cash to set up many of the escrows required at initial and final endorsement or during construction. If a Borrower draw down cash at initial closing to satisfy the escrow requirement, a letter of credit cannot be substituted to establish the same escrow requirement.

2. Ratings and requirements for bank issued letters of credit. When a letter of credit is permitted, the ratings and requirements for banks issuing letters of credit for all multifamily project escrows must meet the following Ginnie Mae criteria:

a. Unconditional and irrevocable;

b. Issued by a bank in a Ginnie Mae rated institution which are insured depository institutions, which can include FDIC or National Credit Union Administration, with a rating that is acceptable to HUD (refer to Ginnie Mae Handbook 5500.3 Rev. 1, Chapter 16-8 dated 04/03/15, and Chapter 31-15(B) dated 09/18/15 for details);

c. Valid and collectible; and

d. Have a 12-month term that is renewable up to the period of the escrow or of the borrower’s obligation and is acceptable to HUD.

e. The format of the letter of credit must follow that in Ginnie Mae Handbook 5500.3, REV-1 Appendix VI-3;

f. The Issuer must be named as beneficiary.

g. The Issuer must execute, in blank, a Transfer of Letter of Credit using the format included in Appendix VI-3, the original of which must be filed with the document custodian; and
h. Any substitute letter of credit or extension that changes the letter of credit number or any terms or conditions of the letter of credit will require a new execution in blank and filing of a Transfer of Letter.

The requirements for depository institutions and deposit accounts are in found in the current Ginnie Mae MBS Guide for Issuers, 5500.3. It is available on Ginnie Mae’s website at the following link: [http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/Pages/MBS GuideLib.aspx](http://www.ginniemae.gov/doing_business_with_ginniemae/issuer_resources/Pages/MBS GuideLib.aspx).

3. The lender of record (as having a financial stake in the Borrower’s position) may not be the issuer of any letter of credit without prior written consent of the Regional Center Director. Such consent will be granted only on an exception basis with sufficient investigation of a potential conflict of interest. If a demand under any letter of credit is not met immediately, the lender must provide the cash equivalent to the remaining balance of the letter of credit.

4. Lines of Credit. On an exception basis and with prior written consent of the Regional Office Director, existing lines of credit may be used to establish a portion of the principal’s financial capability. With the Firm Commitment application, the lender must have the principal provide a letter from a lending institution that confirms:
   a. The existence of the line of credit, original amount and available balance, repayment terms, and expiration date.
   b. The line of credit expiration date cannot occur prior to project completion.

E. Sponsor’s Continuing Commitments.

1. Continuing Commitments. A written statement must be submitted from Active Principals who are Sponsors and are relied on for financial capacity; it must indicate the parameters of their financial commitment to and contractual relationship(s) with the Borrower:
   a. If the relationship is not intended to continue until the project reaches sustaining occupancy, the financial requirements have not been met.
   b. Any Sponsor relied on for financial support but not having an ownership interest in the Borrower must also certify in writing the amount of funds it will commit.

2. The Firm Commitment will contain special conditions to ensure the contractual association of the Sponsor to the project:
   a. The condition must indicate that the withdrawal of any individual/firm relied on for financial capacity requires prior HUD approval.
   b. Identify the individuals/firms relied on for financial capacity. For confidentiality reasons, do not indicate their alphabetic designation or their dollar contribution as they are listed in the Remarks Section on Form HUD-92264-A.
c. Indicate that the withdrawal of any individual/firm relied on for financial capacity could result in HUD declaring the Firm Commitment null and void.

d. Require organizational documents reflecting such continuing contractual relationships, (i.e., for nonprofits).

e. If there is a change in sponsorship of the individuals/firms relied on for financial capacity and the remaining Principals do not demonstrate the capacity to meet the financial requirements of the project.

f. At any stage through Firm Commitment this is considered a significant deviation from the original proposal and a cause for rejection of an application.

g. After the issuance of the Firm Commitment, but before Initial Endorsement occurs, this is considered a significant deviation from the application for which the commitment was issued and may be cause for declaring the Firm Commitment null and void.

3. Individuals are prohibited from submitting financial statements as Sponsor and then abandoning the project and the Borrower after the Firm Commitment is issued. The lender should require a certified statement from such Sponsor stating their commitment to the project and specifying the amount of funds that will be reserved for contingent needs through Final Endorsement and sustaining occupancy.

4. The submission of a financial statement that is used to influence Federal Officials concerning a mortgage insurance risk determination when the Sponsor does not plan a continuing relationship with the borrower could result in appropriate sanctions being taken against the sponsor including suspension or debarment.

F. General Contractor with Adequate Capital. The general contractor’s adjusted working capital position should equal 5% or more of the estimated construction contract.

1. The instructions for hypothecation (See Section 8.5.C.4) of fixed assets may be applied if the general contractor does not have an acceptable working capital position.

2. The general contractor’s ability to obtain a performance-payment bond does not negate or lessen this requirement.

3. Adjust the working capital amount for projects in construction.

4. If the general contractor does not have an acceptable working capital position or sufficient fixed assets that can be hypothecated, a joint venture may be established with a financially stronger general contractor provided these firms’ combined working capital equals at least 5% of all construction contract amounts for projects in construction and development.

5. Waiver of the working capital requirement is reserved to Regional Center Directors and will be considered only when there are specific strongly supported mitigating factors.

6. Pay When Paid subcontracts effect the timing of the payments to the subcontractor, not the requirement to pay, and therefore should have no effect on the working capital calculation. Pay if Paid contracts will relieve the General Contractor’s obligation to pay the subcontractor, however these type contracts, while not prohibited, are generally
discouraged for both policy and risk reasons. Therefore, HUD will generally not permit an adjustment to the General Contractor’s working capital requirements if either contract is used.

G. In the case of LIHTC, Historic Tax Credit or New Market Tax Credit transactions, the application must include a Letter of Commitment/Letter of Intent to fund the required equity from a syndicator or investor. This Letter of Commitment/Letter of Intent must specify the total equity amount, pay-in schedule, and conditional equity pay in benchmarks so the lender can verify the availability of equity. The lender must identify the funding and use of any syndicator or investor-required reserves in comparison to HUD’s reserve and escrow requirements and reconcile any differences in the Lender’s Narrative.

The lender must also review additional documentation (e.g. financial statements, syndication track record/history, etc.) to determine the syndicator or investor’s ability to make all future equity installments. The lender should focus on and evaluate the syndicator’s or the investor’s financial strength, experience, and reputation. The lender should also identify whether they syndicator or investor has a majority ownership interest or identity of interest in the borrower entity, as addressed in Section 8.3.

See Chapter 14 for further guidance on underwriting an application with tax credits.

H. Real Estate Owned (REO) Schedule and Mortgage Debt Schedule must disclose the latest annual year of operations. The purpose of requiring the REO and Mortgage Debt Schedules is to determine an Active Principal’s exposure to any risk associated with their real estate portfolio (e.g. multifamily rental, assisted living, commercial, office, undeveloped land, and new construction versus stabilized properties, etc.). Generally, the REO Schedule lends credibility to asset values reported on the principal’s financial statements by requiring detailed information on each real estate asset and serves as a cross-check to the financial statements. The mortgage debt schedule should include loans that are maturing within the next 5 years or have floating-rate resets within the next 5 years. Other debt that has a material impact on the Principals’ creditworthiness should be included as well (e.g. if they are in default or are likely to have problems with a loan over the next few years) to determine if any of the properties should be classified as a troubled asset. A troubled asset is one that has, or is likely to, defaulted on its mortgage obligations, or has significant financial management or operational problems. The credit evaluation shall include:

1. An analysis of the various properties’ net operating income, outstanding indebtedness, cash flow and valuation estimates must detail and support the lender’s assessment of the likelihood of the Borrower’s successfully refinancing projects that have maturing balloon debt, assuming current capital markets conditions and current availability of alternative long-term financing sources. The analysis should pay particular attention
to Principals with a history or anticipated incidence of adverse credit actions including (but not limited to) bankruptcies, foreclosures or a pattern of renegotiating debt.

2. A financing plan should include both conventional financing and other FHA insured loans, including healthcare loans for any shortfall or anticipated lack of available credit.

3. An analysis of large nonprofit or for-profit entities/owners with large portfolios and audited summary financial statements is required. Generally, the lender can provide summary data, including a description of exposure to maturing debt obligations, a detailed listing and analysis of troubled projects, including those with recent or anticipated defaults or other material adverse actions.

4. If a tax credit syndicator is identified, the lender’s underwriter will also need to provide a brief overview and analyses of the entity. Typically, a tax credit syndicator is an investor intermediary with only a limited ongoing obligation to LIHTC rental properties. Accordingly, an REO schedule is not required for tax credit syndicators or investors. However, the syndicator’s liquidity, track record, asset management and monitoring capability and ability to perform on its commitment to provide equity to the borrower after Initial Endorsement is a material issue for HUD Senior Underwriter’s analysis of the tax credit investor/LP.

5. The lender may present the REO and mortgage debt schedule in tabular format containing the information covered below and any other information sufficient to present their analysis and conclusions. Typically, the format is a spreadsheet accompanied by a summary description and analysis of each project. When the REO schedule materially differs from the financial statements and are not minor variations arising from timing of statements or changes in principal balances, then the lender should investigate, reconcile and explain the differences. Refer to Appendix 8A for the itemized physical property list and the schedule of mortgage debt.

8.6 Prior Approval of Principals/Borrowers with FHA-Insured Balances Greater than $500 Million or 25 or More Commercial Real Estate Assets

A. Purpose. Prior credit approval of a principal is a specialized review of a large borrower to manage risk and promote efficient program application processing.

HUD manages risk with a prior approval review by 1) determining whether an active principal represents a reasonable credit risk given the operating performance, age, utility and physical condition of the principal’s existing FHA insured, including HUD assisted and other properties; 2) determining the amount of any new mortgage insurance
commitments that may be extended to a principal given their credit history, cash flow, net worth, liquidity, scheduled debt maturities and operational stability; and 3) identifying and evaluating the risks arising from any unique combination of assets that may suggest an adverse circumstance that could impact the stability of the principal’s portfolio, such as concentration in a particular asset type, industry sector or geographic or market concentration;

The prior approval of principals also assures a consistent, timely and efficient response to active principals with portfolio holdings which may be scattered among numerous Multifamily Regional Centers. In addition, it enables the largest users of FHA programs to plan for future property development or acquisition relying on financing available through the insurance programs.

B. Principal Types, Mandatory or Voluntary Approval

1. Mandatory. Two Principal types must receive HUD’s prior credit approval before submission of the application, if the REO portfolio exceeds a threshold (see next section):
   a. Principals normally subject to application-level mortgage credit underwriting as defined in MAP Guide 8.3.B.1 and 8.3.B.2.
   b. Investors participating exclusively as Passive Principals, as described in MAP Guide 8.3.B.3, except whose interest is not fixed or some form of continuing or contingent responsibility exists (e.g. a future equity investment obligation).

2. Voluntary. Any Principal who anticipates submitting multiple applications within a 12-month period may request voluntary prior credit approval, thus eliminating redundant mortgage credit reviews normally required with each project application.

C. Threshold. The threshold for a mandatory review is either of the following conditions:

1) the principal is a participant in FHA insured projects with outstanding loan balances greater than $500 million (unadjusted for ownership interest) OR 2) the principal’s REO schedule shows at least 25 commercial real estate assets. Changes in the principal’s REO schedule resulting from Transfer of Physical Asset (TPA) transactions may trigger a mandatory prior credit approval request or, in cases where an active prior credit approval exists, the lead lender must ensure a TPA is in compliance with the decision’s insured loan balance limit.

D. Future Application Applicability. Prior approval applies to future applications of MAP multifamily and healthcare loan programs. Not applicable are future refinancing applications pursuant to Section 223(a)(7) or Housing Finance Agency or Government Sponsored Enterprise risk-sharing loans.
E. Effective Date and Duration. A prior approval decision will be effective and may be relied upon for 24 months or lesser period specified by HUD, from the date of the credit approval.

F. Lender Submission and Procedure. The MAP lender must prepare a specialized mortgage credit review for the subject principal(s). Key areas include individual/corporate financial analysis, REO analysis and key performance metrics (both overall and FHA insured segment), ownership/investment strategy analysis, geographic concentration risk, key person dependency risk, proposed FHA financing analysis, and management agent analysis.

Appendix 8.C & 8.G sets forth the instructions and requirements for MAP lenders to file a prior approval request. The lender should deliver the prior approval submission to the HUD Regional Center most relevant to future application activity. The Regional Center will then forward this presentation to HUD Headquarters Office of Multifamily Housing Production for review.

8.7 Secondary Financing

The amount, form, terms and conditions of any permitted secondary financing must comply with the guidance herein and 24 CFR Sections 200.71 and 200.85. This section details new source(s) of secondary funding. Except as specifically noted in this section, the term of any subordinate loan may not mature before the term of the HUD-insured first mortgage. Additional secondary financing guidance for Low Income Housing Tax Credit projects is found in Chapter 14.14.

A. Public Sources. For all Sections of the Act (SOA), when secondary financing is funded by sources such as HOME funds, Affordable Housing Program, Federal Home Loan Banks (FHLB), Grants, or other quasi-public, federal, state, or local governmental sources:

1. The subordinate loan must be documented by a promissory note (with terms similar to Form HUD-92223M, Surplus Cash Note) and may be secured with a mortgage lien as prescribed by the governmental funding source and reviewed and approved by HUD and made subordinate to the HUD-insured first mortgage using Form HUD-92420-M, entitled “Subordination Agreement - Public.” At a minimum, the associated note will need to contain the following language from Section 8.7.E below. Note that the parties will need to execute and record a Subordination Agreement and the note will need to conform to the terms in Section 3 of the Subordination Agreement.

2. Secondary financing (or grants lent to the property as a secondary loan) may be used to offset up to 100% of the applicable SOA equity requirements, and may also be used to finance non-mortgageable costs, which when added to the HUD mortgage and required equity contribution, may exceed 100% of the project’s total cost. None of these sources
may be substituted for Tax Credit Equity and all remain subject to the cumulative 75% limit on payments from surplus cash.

3. Non-mortgageable costs (i.e. replacement cost items, not eligible for inclusion in the HUD insured loan) to be financed by the secondary loan, must be certified by the funding source to be reasonable and necessary to complete the project. Documentation to this effect must be included with the application submission.

4. While the term of a subordinate loan is coterminous with the HUD insured first mortgage. However, the HUD underwriter may consider exceptions on a case-by-case basis for public debt when other HUD programs (e.g., the HOME program, National Housing Trust Fund) require shorter amortizations and the risk is mitigated. Examples of mitigants include items such as significant additional public funds, low loan-to-value or loan-to-cost ratios, below market rents or higher than minimum debt service coverage.

5. Where the source of the secondary financing is HOME program funds, HUD will permit the Rider/Restrictive Covenant Agreement to be modified such that the restrictive covenants will survive foreclosure of the FHA insured security instrument.

B. Private Sources – Section 223(f).

1. Secondary financing from a private lending source must be evidenced by a promissory note (Form HUD-92223M Surplus Cash Note or Form HUD-92908M Residual Receipts Note) that may not be modified or altered in any manner without the written consent of HUD. If secured by the Project, the private loan must be subordinated to HUD-insured loan with Form HUD-92907M Subordination Agreement – Private.

Private secondary financing is permitted to offset mortgageable and nonmortgageable costs up to the difference between the loan-to-value percentage and a maximum combined debt of 92.5% of the fair market value (FMV), except in instances when private secondary financing is combined with federal, state or local governmental agency secondary financing. (In these instances, the governmental loan, in aggregate with the HUD first and private second, may exceed the property’s FMV.) The 92.5% limitation on combined debt does not apply to Low Income Housing Tax Credit transactions, in which primary and secondary debt together may equal but not exceed 100% of total development costs. (See Chapter 14 for details.)

2. Private secondary financing up to 92.5% total LTV (including both HUD-insured and private secondary financing) may be secured by a lien encumbering the real property.

3. Mezzanine Financing. Mezzanine financing is a subordinate loan usually secured by a pledge of ownership interests, rather than by a secondary lien on the real estate or an
obligation of the Single Asset Mortgagor Entity. Mezzanine debt terms must be fully disclosed to and approved in writing by HUD. Any mezzanine debt that remains from a previous financing of the property is subject to the secondary financing guidance in this section. Payments on mezzanine financing may be made only from surplus cash, and the debt may not mature before the FHA insured loan. Mezzanine loan interest rates will typically be higher than that of the first mortgage but must be reasonably consistent with market rates for mezzanine debt. Additionally, the interest rate must not be so high that it jeopardizes the ownership stability of the property, or that the interest due cannot reasonably be expected to be repaid from surplus cash. Interest due or accruing on the mezzanine loan must be approved as reasonable by HUD.

In the event of nonpayment or default on the mezzanine debt, any transfer of an ownership interest in the borrower entity or in its principals to the mezzanine lender must have prior written approval by HUD, through the Transfer of Physical Assets (TPA) process. The mezzanine lender may exercise no enforcement remedies against the real estate or against the borrower entity during the term of the mezzanine loan, nor may the mezzanine lender take action that would trigger a Transfer of Physical Assets (TPA) without HUD approval.

NOTE: Project-specific exceptions or waivers to these policies for mezzanine financing must be approved in writing by HUD and documented in a HUD-2 waiver form.

C. Private Source — New Construction/Substantial Rehabilitation. Private secondary financing is not permitted under Section 221(d)(4) or other new construction/substantial rehabilitation first mortgage programs. The only exception to this consideration is Seller-financed secondary debt (aka seller take-back note). The Seller-financed secondary debt must meet the following criteria:

1. The FHA loan to replacement cost ratio is less than 50% (80% loan ratio for tax credit applications) of mortgageable cost; and

2. The Seller financed secondary debt is either:
   a. An arms-length transaction; or
   b. It involves an identity of interest transaction and the selling price of the land or building is not greater than the property’s “as is” value.”

3. Seller-financed secondary debt must also meet all of the following:
   a. It is an inferior cash flow debt, i.e. cumulative payments for all subordinate debt must not exceed 75% of surplus cash, if available.

   b. It is documented in a promissory note that is not recorded and not secured with a lien against the property; this prohibition on a lien does not apply to LIHTC transactions.

   c. It does not contain any provision of foreclosure that would threaten the first mortgage.
d. It is subject to automatic re-subordination in any subsequent refinancing of the first mortgage; and

e. The subordinate debt does not have a balloon payment or maturity prior to maturity of the FHA-insured first mortgage.

D. Section 223(a)(7) Refinance Program. For Section 223(a)(7) applications, secondary financing terms are governed by the SOA of the underlying insured mortgage but shall not be used directly or indirectly to provide funds for an equity takeout or a Transfer of Physical Assets.

E. Commitment Condition for Repayment of Public or Private Secondary Financing (Subordination Agreement – Public (HUD-92420M) and Subordination Agreement – Private HUD-92907M). Required repayment of this and any other secondary debt, including interest, must be made solely payable cumulatively from up to 75% of available surplus cash. Consider using Form HUD-92223M or including the following language in the secondary financing promissory note, or otherwise ensure the transaction provides for the following:

"So long as the Secretary of Housing and Urban Development or his/her successors or assigns, are the insurers or holders of the first mortgage on (insert project name and FHA Project No.), the total payment(s) due under this Note, and all other secondary debt instruments shall be payable shall not cumulatively exceed 75% of available surplus cash. Non-project sources that are outside the Mortgaged Property may also be used to repay subordinate financing. The term surplus cash is defined in the Regulatory Agreement dated (insert date) between HUD and (insert name of borrower). The restriction on payment(s) imposed by this paragraph shall not excuse any default caused by the failure of the maker to pay the indebtedness evidenced by this Note."

This language does not need to be added to the Subordination Agreement – Public (HUD-92420M) or the Surplus Cash Note (HUD-92223M)

F. Secured Public Secondary Financing Conditions. The borrower may secure a Surplus Cash Note (HUD-92223M) with a subordinate lien from a governmental agency against the property under the following conditions:

1. The lender on the insured mortgage must consent to the placing of the subordinate lien and agree that its existence could not create a basis for default on the first mortgage.

2. There must be a simultaneous closing of the subordinate financing documents and the insured first mortgage loan documents. Both the subordinate and first mortgage closing documents must be recorded prior to or on the day of closing. Please note that recordable closing documents are frequently recorded in advance of actual closing, however funds do not flow until closing. See Section 19.1.03.D for details on closing arrangements.

3. The terms of the subordinate mortgage must be:
   a. Approved by the Field Counsel.
b. Consistent with the terms of the insured Surplus Cash Note, the first mortgage, the Regulatory Agreement and all HUD regulations and requirements.

c. The subordinate mortgage shall not contain a cross default provision or any right of foreclosure before the termination of the FHA insured mortgage.

d. The term of the subordinate mortgage must be extended, if:

   1) The Promissory Note is due, and there are no surplus cash funds or residual receipts available for repayment, and the first mortgage has not been repaid in full. (Distribution of residual receipts must be approved by HUD Asset Management and can only be approved by the terms of a written agreement between HUD and the owner.)

   2) HUD grants a deferment of amortization or forbearance that results in an extended maturity of the insured mortgage.

   3) The maturity date of the subordinate mortgage is prior to the term of the FHA-insured mortgage.

e. The subordinate mortgage must be assumable when a sale or transfer of physical assets occurs, and the insured mortgage remains in place.

   1) The holder of the subordinate mortgage cannot require that more than 75% of the net proceeds of the sale or transfer be applied to the reduction of the loan.

   2) For these instructions, net proceeds are the funds available to the original borrower after:

      a) Correcting any monetary or covenant default on the first mortgage.

      b) Making:

         i) Required contributions to any reserve funds.

         ii) Needed improvements to the property as evidenced by HUD's annual inspection reports.

f. The subordinate mortgage must automatically terminate if HUD acquires title to the project by a deed in lieu of foreclosure.

g. No more than 75% of surplus cash may be pledged to the repayment of the subordinate loan(s).

G. Unsecured Private Secondary Financing Conditions. Terms of unsecured private Promissory Notes must reflect those provisions found in: Form HUD-91710M, Residual Receipts Note [Non-profit Borrower], or Form HUD-91712, Residual Receipts Note [Limited Dividend Borrower], or Form HUD-92223M, Surplus Cash Note [Profit Motivated Mortgagors] based upon the type of borrower; or Form Residual Receipts Note (HUD-92908M), when Borrower’s distributions are restricted through a Residual Receipts Rider to the Regulatory Agreement. See the Closing Chapter 19 Section 19.2.08.B for further details.

   1. Form HUD-91710M, Residual Receipts Note (for Non-profit Mortgagors) and Form HUD-91712M, Residual Receipts Note (for Limited Dividend Mortgagors).

      a. Principal and interest shall be due and payable on or after the maturity date of the HUD-insured mortgage.
b. If the HUD-insured mortgage is prepaid in full, the holder of the residual receipts note has the right to declare the entire principal sum or any remaining balance including any accrued interest immediately due and payable.

c. Prepayments to principal and interest:

   1) may be made (a) from the residual receipts as defined in the Regulatory Agreement only after obtaining written approval from HUD or (b) from sources other than Project Income or Project Assets, e.g., syndication proceeds.

   2) may be made only after final endorsement of the insured mortgage and after the end of a semiannual or annual fiscal period.

   3) if unauthorized prepayment is accepted, the funds shall be returned to the project immediately upon discovery.

d. The residual receipts note is nonnegotiable and may not be sold, transferred, assigned, or pledged by the payee.

e. Presentation, demand and notice of demand, nonpayment and protest of the residual receipts note are waived.

f. Interest on the note must not compound, however for LIHTC and otherwise affordable projects, HUD will consider compounding of interest pursuant to the instructions in Section 14.11.A.5 of the MAP Guide.

2. Form HUD-92223M, Surplus Cash Note (for all other mortgagor entities). The conditions and limitations are the same as Form HUD-91710M, except that:

a. Provisions may be made for interest payments annually or semiannually or at the end of a fiscal period. However, the Note should provide for interest to accrue and be payable in full at maturity.

b. Prepayment of principal or any payment of interest must be limited to sources other than Project Income or Project Assets, e.g., syndication proceeds or surplus cash as defined in the Regulatory Agreement.

c. Payments on promissory notes will be made only as permitted by the applicable Regulatory Agreement, but prepayment of the promissory notes from sources other than the project is permitted without HUD approval.

d. Should any unauthorized prepayments be made, as determined by HUD, it shall be the responsibility of the borrower to return them to the project.

e. Interest on the Note must not be compounded, however for LIHTC and otherwise affordable projects, HUD will consider compounding of interest pursuant to the instructions in Section 14.11.A.5 of the MAP Guide.

H. **Tax Credit Equity Bridge Loans.** Tax credit equity syndicators or investors (with or without an identity of interest with the MAP Lender) may make bridge loans to fund required equity
contributions for LIHTC, Historic or New Market Tax Credits during the construction or substantial rehabilitation period as described in Chapter 14.14.

I. Identify all subordinate loan funds in Section III “Source of Funds to Meet Cash Requirements” Form HUD-92264-A.

8.8 Required Application-Processing Exhibits and Lender and HUD Responsibilities

The lender shall utilize HUD’s standardized application exhibit checklist to facilitate the electronic submission of the application to aid in HUD’s completeness review of deliverables and to record underwriting processing results and conclusions for both pre-application and firm applications. The standardized checklist is a concise structured template organized with separate sections directly related to each technical discipline. The template will permit the HUD-delegated underwriter and lender to locate exhibits within the application binder, which will in turn expedite the application review process while reducing HUD’s risk during the underwriting analysis of the application. These application templates are for use for all program applications submitted under the Multifamily Accelerated Processing with the exception of Section 223(a)(7) applications. The lender’s application submission templates for mortgage insurance are:

1. Underwriter’s Narrative
2. Application Checklist
3. FHA Summary Report (The Wheelbarrow)

A. General Responsibilities of Lender’s Underwriter.

Underwriting multifamily projects is a process for evaluating the character, capacity and creditworthiness of the sponsor, borrower and its principals, the general contractor, and in the instance of an identity of interest, the property management company, in order to reach specific conclusions resulting in the approval (with conditions, as appropriate) or denial of a mortgage insurance application.

The Lender must assess the borrower’s ability to manage all of the responsibilities of the ongoing operations of multifamily properties, including the development, construction, completion, and lease-up for new construction proposals and property maintenance, tenant relations, financial and performance reporting and effective management for existing properties.

The lender’s underwriter must:
1. Identify the borrower and its principal entities or individuals and present a complete, consistent and coherent picture of the financial capacity and creditworthiness of the borrower and the various Active Principals.

2. Analyze the creditworthiness of the sponsor(s), the borrower entity, if formed, and its principals and/or individuals and the contractor. If a borrowing entity is not yet formed at the time the firm application is submitted, the MAP Underwriter must still perform the financial and credit analysis on the Active Principals and/or individuals. The underwriter must demonstrate that the principals and/or individuals have the character, capability, creditworthiness and commitment to provide expert leadership, working capital and cash needed to close the proposed transaction(s), complete the development process, as applicable, and to support the operations of the property. This determination is made in light of the obligations that may already be required of the principal due to ownership of other business interests and real estate projects.

3. For existing mortgagor entities and properties, evaluate the financial performance of the mortgagor and the property based on its financial statements and other operating reports, (e.g., rent rolls) and credit history to determine eligibility, mortgage amount and conformance to program requirements.

4. Conduct a mortgage credit review to include:
   a. The balance sheets for principals as discussed in Appendix 8B, “How to Analyze Financial Statements” and in addition to the Schedule of Real Estate Owned and other relevant schedules.

   In each case the lender will conduct sufficient diligence to determine what should be an appropriate period of past financial review. Character is best demonstrated during periods of economic distress and so a review of at least one complete business cycle (means the entity’s fiscal year) is necessary. Any material credit problems in the last 2 to 5 years should be carefully reviewed and may result in an application rejection. Events that occurred before that period if, for example more than 8 or 10 years have passed, would not have as material an impact on creditworthiness but may still be relevant. The lender should consider all relevant factors in the analysis and credit approval decision.

   b. Determine whether the sponsor(s) has (or will have, given proposed transactions) existing insured mortgage balances exceeding $500,000,000. If a sponsor has obtained prior approval to exceed this amount, submit a copy of the Prior Approval
Decision together with any other documents identified as required by the Prior Approval Decision. (See Appendix 8C for prior credit approval instruction.).

5. Determine if there is incomplete or inconsistent information, or discrepancies between the information included on the financial statements and in the credit reports. Any inconsistencies must be reconciled.

6. In addition to the formal documents and credit investigation described above, the lender’s underwriter must conduct and describe the results of an internet search of each principal and determine if there is any information that raises concerns about credit worthiness and address any negative information.

7. Provide the Office of Foreign Assets Control (OFAC)/Terrorism checks and verifications on principals which are required by the U.S. Patriot Act. These checks must be completed and documented no later than the time of Initial Endorsement, whether or not the lender is a regulated financial institution. The OFAC verification is not part of MF Regional/Satellite Office review except to the extent that the lender has identified problems during the OFAC check. OFAC requirements are administered by the Department of the Treasury and lenders should refer to the Treasury’s website http://www.ustreas.gov/offices/enforcement/ofac, for any questions.

B. Additional Exhibits Required of Project Participants.

The borrower shall provide the following exhibits for the following participants:

1. Exhibits required for participating professionals, officers of corporations:

   a. Identity of Interest of Borrowers Using BSPRA - General contractors with an identity of interest with the borrower may be either independent businesses with an ownership interest created in the borrower entity primarily to obtain the Builders and Sponsors Profit and Risk Allowance (BSPRA) or businesses owned and operated by a Principal of the Borrower. Notwithstanding any identity of interest, the general contractor is required to provide the identical exhibits as a participant.

   b. Management Agent - A detailed resume is required for management agents even when they have no ownership interest in the Borrower entity or identity of interest with a Principal. Credit reports are only required for the management agent in cases where there is an identity of interest between the owner and the management agent, or in cases where the management agent holds an equity interest in the borrower. Also, receipt of negative information concerning the performance or capacity of the management agent could require a credit review. Analysis of financial statements is
generally not required, unless the agent has an identity-of-interest with the borrower or a Principal, or where financial statements are necessary to evaluate the capacity of the management entity to perform its management role.

c. Fee Developer/Consultant - Fee developers, packagers, consultants and other professional persons or organizations are sometimes retained to assist nonprofit Sponsors that might lack needed experience. Such services might include assisting with project development, financial structuring or HUD processing. Packagers and consultants must provide resumes evidencing their qualifications, and the developer must provide credit reports and financial statements when their services are critical to project viability.

d. Design Architect/Engineers - Design professionals must provide resumes establishing their credentials, competence and experience commensurate with levels of expertise and experience required by the project. Absent an ownership interest in the Borrower that would otherwise qualify the design professional as a Principal, no other mortgage credit exhibits are required.

e. Executive Officers of Borrower - Officers with less than 10% of the voting stock of a for-profit corporation but who qualify as a principal of the Borrower, may be required to submit resumes and demonstrate appropriate competence and experience to provide an accurate picture of character, capacity and commitment.

f. Executive Officers and Directors of Publicly Traded Corporations - are not required to submit mortgage credit exhibits as individuals, notwithstanding their stock ownership inasmuch as such firms are regulated by the U.S. Securities and Exchange Commission (SEC). The SEC-required annual corporate report (Form 10-K) and quarterly corporate report (10-Q) provide complete financial statements, background and history of corporate operations as well as resumes and compensation of corporate officers and disclosure of conflicts of interest of officers and directors. In addition, the credit of publicly traded corporations is rated by agencies such as Standard and Poor’s, Fitch and Moody’s. When a publicly traded corporation is a Principal, Forms 10-K and 10-Q and agency credit ratings may be accepted in lieu of mortgage credit exhibits.

C. Evaluating Nonprofit Sponsors and Borrowers

1. General.

Nonprofit Borrower/Sponsors (whether national, regional, or local) must have the experience and financial strength appropriate for the development and ownership of the proposed property, see Section 8.3.B. The nonprofit sponsor being evaluated may not have equal strength with respect to all criteria. In transactions where the Borrower/Sponsor’s
ownership structure contains multiple entities performing differing functions, the lender must evaluate the nonprofit and each of the other entities on their capacity to perform its particular function, e.g. ownership, property management, acquisition, development, resident services or asset management. This includes the need for prior acceptable history of successful development, ownership and management of assets similar in size and complexity as the proposed project. Therefore, only the criteria for the areas in which the nonprofit entity has direct responsibility or authority need to be applied during the evaluation process. The eligibility of prospective nonprofit Sponsor/Borrower must be determined before a Pre-application approval or Firm Commitment is issued.

The lender must include in the Underwriter Narrative summary a description of the party(s) paying pre-development costs, in addition to the following written explanations:

a. Details of any proposed rent/income restrictions on the property to be developed by the nonprofit.

b. Developer’s Agreement or any other document which shows the relationship and work responsibilities of all parties associated with the transaction.

c. Explanation of the terms and conditions of the Housing Consultant’s contract, if applicable. The fee for the Housing Consultant shall be an expense of the borrower.

d. Memorandum of findings and recommendations:

1. Must include a description of the relationship between the nonprofit and any profit motivated entities involved in the transaction.
2. The determination of eligibility or ineligibility of the nonprofit sponsor/borrower must be approved by the HUD office with jurisdiction.
3. At the Firm Application stage and prior to initial endorsement (beginning of construction in the case of Insurance Upon Completion), describe the sponsor’s and borrower’s relationships with parties or firms furnishing land and services.
4. Describe any signed agreements of relationship between such parties or firms with the sponsor and borrower.
5. All relationships are subject to HUD approval therefore the sponsor and the borrower must inform HUD in writing if there is a change in any signed agreements of relationship.

e. Explain any nonperforming assets in nonprofit borrower/sponsor portfolio in conjunction with the REO review.

f. Detailed explanation of the motivation for sponsoring the project including a history of the organization’s involvement in multifamily housing.

g. The management agent must have a minimum of 3 years of experience in managing at least 5 properties comparable to the proposed property in scale, complexity and regulatory compliance requirements. A property manager must demonstrate
adequate property management experience with properties comparable to the subject property.

h. Signed written resolution of the nonprofit’s directors or trustees, acknowledging the responsibilities and obligations of sponsorship and continuing ownership, and that the subject proposal reflects the will of the board and/or the membership of the organization.

i. Detailed statement of arrangements made or proposed for the following (listing principals involved, their relationship with the nonprofit sponsor/borrower, the terms of the arrangements and the circumstances surrounding each):

1. Land on which the project will be built including the existing length of ownership.
2. Project construction/rehabilitation, including selection of general contractor, subcontractors and architect.
3. Legal and consulting services.
4. Project financing, including any discounts.

NOTE: A national, State or regional organization acting as a cosponsor must submit a separate Form HUD-3433 and Supplemental documentation.

j. The nonprofit sponsor must have diverse and stable funding sources with recurring revenue and, if required, a proven record of raising sufficient funds to meet its operating needs. The lender must identify whether the nonprofit sponsor’s primary funding sources are from fees on development projects or from sources such as public funding, public contracts, grants or donations that may be subject to budget or funding constraints.

D. Mortgage Credit of the Nonprofit Sponsor and Nonprofit Borrower.

1. The underwriter narrative should describe how the nonprofit sponsor/borrower is qualified to start, complete and operate a project under the insured loan programs. The lender must determine that the nonprofit sponsor/borrower is acting on its own behalf, or if either knowingly or unwittingly acting under the influence, control or direction of any outside party seeking to derive a profit or gain from the proposed project—such as a landowner, real estate broker, contractor, architect, attorney or consultant.

2. Credit investigation analysis.
   a. As with for-profit sponsors, the lender’s underwriter must make a determination of the individuals and entities with decision-making and operational authority over the
project. The underwriter will provide an in-depth written analysis on the aspects of the mortgage credit review in the underwriter’s narrative.

b. Check that the borrower/sponsor has no unresolved issues related to payment history and check credit references.

3. Financial data analysis.
   a. Determine the amount of cash and liquid assets available for investment in the project and overall financial condition of the sponsoring group, and in particular whether the financial statements indicate that income will be sufficient to meet the expenses incurred by the group.
   b. Financial statements of many large nonprofit organizations show various fund accounts, such as general and building fund, etc.
      1) Identify any inter-fund receivables and payables that cancel each other.
      2) Do not consider restricted-use funds in the analysis.
      3) Review the Public Records section of the credit report to eliminate assets, which were used as collateral in secured borrowing.
   c. The project size and complexity should be consistent with the abilities of the sponsoring organization.

E. Nonprofits may earn a non-profit developer fee, but not BSPRA, on a new construction or substantial rehabilitation proposal under Sections 220, 221(d)(4), 231, or 241(a).

F. Nonprofit Borrowers may include a consultant fee as part of the replacement cost to be paid from the Organizational line item. The selection of a housing consultant is the responsibility of the Sponsor/Owner who will execute a consultant contract or agreement that engages the consultant to assist the Sponsor/Owner in the development process. The MAP Lender will review and explain the terms of the housing consultant contract in the Underwriter’s Narrative but does not approve the contract nor determine compensation limits. The resume(s) are to be submitted with the FHA loan application. HUD will permit a consultant fee under the following conditions:
   1. As currently permitted, as part of the developer fee where one exists.
   2. Where a developer’s fee is not permitted in the loan, including those loans that use a BSPRA, a consultant fee may be paid from the Organizational line item in Section G on Form HUD-92264.
   3. Use of a consultant fee is limited to nonprofit sponsored projects that have retained a consultant to assist in the origination, development, financial services (non-tax credit deals)
and/or loan processing of the project. The agreement between the Nonprofit Borrower and consultant shall outline the services to be provided and fee amount.

4. The fee amount shall be based upon complexity of the transaction but limited to the greater of $40,000 or 10 percent of the estimated total for all improvements, total carrying charges and total legal, organizational and audit fees; and

5. No more than 50% of the consultant fee shall be paid at initial endorsement, with the remainder to be paid during the construction period and final endorsement as described in the consultant contract.

G. Nonprofit Sponsor and a Profit-Motivated Borrower Entity.
   A nonprofit sponsor may establish a profit-motivated borrower entity for the purpose of owning a tax credit project or obtaining BSPRA and distributions cash. are limited to 75% of available surplus cash. Such a request may be approved provided:

1. The Borrower’s legal counsel’s opinion determines that there is no legal impediment that would prohibit approval of this relationship structure.
2. The profit-motivated borrower entity agrees to be regulated by the terms and conditions of the regulatory agreement (Form HUD-92466M, Regulatory Agreement Multifamily Housing Projects) applicable to a profit-motivated entity.
3. The nonprofit is subject to the mortgage limitations applicable to a profit-motivated entity.
4. A working capital deposit is required.
5. A nonprofit developer’s fee is not included in the mortgage; the nonprofit can include BSPRA.
6. If the nonprofit provides evidence that it has obtained exemption from real estate taxes, the tax exemption must run with the real estate and not with the type of sponsorship.
7. The Borrower’s legal counsel’s opinion addresses any potential tax consequences and determines there will be no change in the nonprofit’s Section 501(c)(3) tax-exempt status with IRS.
8. The nonprofit sponsor is the Section 50 signatory, see Section 8.3.F.3 for guidance.

H. Lender’s Review and Recommendation

The lender’s underwriter’s recommendation, after review of all processing materials and third-party reports, is made in a separately bound report addressed to HUD included in the underwriter’s narrative.

1. The report must detail the project’s financial requirements and the credit capacity of the sponsors, borrower entity, its principals and the general contractor. The lender’s underwriter’s narrative must detail the project’s financial feasibility with an analysis of the primary risks, any mitigating factors, and the rationale for any waivers requested. The
mortgage credit analysis must contain evidence of the financial feasibility and acceptability of the single asset entity, of each principal with decision making control and of investors providing funds for initial closing. Include at a minimum, the:

a. Name of the borrower entity.

b. Composition of the borrower entity include the tiers showing principals with control and providing the financing.

c. Name of the general contractor, disclosing any relationship(s) with the borrower entity.

d. Mortgage amount and controlling criterion.

e. Financial requirements for closing.

f. Sources of funds to meet cash requirements, including all sources and disclosing how the money will be used.

g. Ratio of loan proceeds to actual cost for the purpose of cost certification.

h. The experience level of the development team relative to the proposed project.

i. A credit and financial review of sponsor(s)/borrower and principals and general contractor. This review must provide an overview of their financial strength, liquidity, experience, and creditworthiness and address positive and negative findings known by the lender.

j. Completion Assurance requirements. (See Section 3.2.G)

k. Recommendation to accept or reject the proposed project.

l. If accepted, any conditions to be included in the commitment. (See Chapter 11)

2. Complete Form HUD-92264-A and exhibits for the type of mortgage proposed.

3. The lender must transmit to HUD all borrower submissions and related documents.

The lender will analyze the stability of the principal’s portfolio ownership and management structure, portfolio characteristics and market conditions and recommend prior approval of creditworthiness. The analysis shall include:

i. Review of the stability of ownership and management.
ii. Evaluation of any problems and challenges confronting the principal and the principal’s plans for action in response to such challenges including:

iii. Underperforming properties, (e.g., properties at less than 90% occupancy; properties at less than 1.1 to 1 debt service coverage; properties with significant physical or management problems).

iv. A review of REAC scores for existing HUD properties. Explanation and corrective action for properties having a score of less than 65.

v. Existing defaults and/or pending capital transactions, (e.g., anticipated refinancing or refunding, pending balloon payments, interest rate resets).

vi. Property or Asset Management deficiencies, (e.g., underfunded reserves, deferred management fees).

vii. Suits, judgments, liens or related adverse actions.

viii. Weak or unstable markets affecting geographically concentrated properties or other actual or prospective adverse conditions affecting a unique combination of assets and the impact of such conditions on the portfolio.

ix. A determination whether the principal’s reputation, past performance and capacity support a conclusion that insured assets will be maintained in good physical condition, with timely capital replacements and prompt, effective action to remedy problems.

I. Mortgage Credit Duties of HUD

1. Concentrated Risk Prior Approval - Confirm that the lender has correctly determined if prior approval is required for the sponsor to file an application. (See Appendix 8C for prior credit approval instruction).

2. Previous Participation - Perform the electronic 2530 review and approval process.

3. Underwriting Conclusions - Review lender’s preliminary analysis and recommendation about the Development Team’s financial capacity, experience and creditworthiness and the lender’s analysis of any defaults, mortgage relief, assignments, and foreclosures relating to these projects.

4. Verify Sources of Funds - HUD will verify, through use of the Form HUD-92264-A and documents supplied by the lender, the source(s) of funds to meet cash requirements.
8.9 Term of Mortgage and Commencement of Amortization

A. Sections 220, 221(d)(4), 241(a) and 231 projects:

1. Term: The term of the mortgage is the lesser of 75% of the estimated remaining economic life of the physical improvements or 40 years from the date of the first payment to principal. Express the mortgage term in whole or partial years, with a partial year expressed on months, for example 26 years, 3 months.

2. Amortization starts:
   
a. For Insurance of Advances projects amortization begins no later than 4 months (after the scheduled construction completion date as estimated in the Firm Commitment. (e.g. for a 16-month construction period, amortization begins on the first day of the 20th month).
   
b. For Insurance Upon Completion project, the first day of the second month following the date of Final Endorsement.

3. Section 241(a) projects:

   Term: The Section 241(a) loan should generally be coterminous with the underlying FHA-insured first mortgage, if that loan has more than 25 years remaining on its term.

   Amortization: If fewer than 25 years remain on the term of the first mortgage and so long as the term of the insured mortgage is no greater than 75% of the project’s remaining useful life, HUD will consider an amortization period up to 40 years regardless of the underlying first mortgage’s amortization period.

B. Section 207 pursuant to 223(f) projects:

1. The maximum term of the mortgage is 35 years or 75% of the estimated remaining economic life of the physical improvements, whichever is less, provided that the term may not be less than 10 years.
   
a. The mortgage term shall be the eligible number of whole or partial years between 10 and 35.
   
b. Express a partial year in months for example 26 years and 3 months.

2. Amortization starts on the first day of the second month following the date of the Initial/Final Endorsement.

C. Section 223(a)(7) projects:

1. Most transactions are processed with a lower interest rate and re-amortized either within the remaining term or with an extension of up to 12 years. Exceptions are detailed in
chapter 18. Extended amortizations may reduce risk to the Department by lowering debt service requirements so long as the cost not attributable evidences the physical condition supports the extended term of the mortgage. In every case, the loan term cannot exceed 75% of the remaining useful life of the property.

2. Amortization starts on the first day of the second month following the date of the Initial/Final Endorsement of the mortgage.

8.10 Sections 220, 221(d), 231, 241(a) Firm Commitment Processing: Determining Mortgage Amounts, Cash Requirements and Related Items

A. Firm Commitment Processing.

1. New Construction Loan Limits. For new construction, the insurable loan amount is the lowest of four criteria on Form HUD-92264-A, Supplement to Project Analysis: the application amount, the cost amount, the statutory limits amount, and the debt service amount, which are described below. Refer to Appendix 3A for the applicable program’s required maximum loan ratios and the debt service coverage ratios needed to complete criteria for Firm applications for new construction and substantial rehabilitation:

a. The Application amount.

b. The Amount Based on Value or Replacement Cost. The result of lender's estimate of the replacement cost after completion, multiplied by the applicable program percentage.

c. The Amount Based on Limitations Per Family Unit - Statutory Limits.

The Statutory limits are determined by an amount attributable to per unit limitation type as adjusted by the High Cost Percentage (HCP) and dwelling use (excluding land).

Record the sum of costs not attributable to dwelling use from Section M Line 15, Form HUD-92264. Insert the same program percentage loan to cost ratio noted in A.1 above. Multiply the sum of costs not attributable with the percentage loan to cost ratio and record sum.

Strike through “site not attributable to dwelling use” and insert the full value of the “warranted price of the land” (see Section G Line 73a, Form HUD-92264) or the full amount of the “as is” value of the land without the improvements if the transaction is a substantial rehabilitation loan (see Section H Remarks, Form HUD-92264).

The total of all costs not attributable multiplied by the percentage loan-to-cost ratio is added to the maximum statutory limit calculated for the number of by unit type. The
sum is the criterion mortgage amount. Strike a line through or leave blank the “Total Number of Spaces,” field, this is no longer applicable.

For the latest High Cost Percentages visit the HUD web site at: 

d. Amount Based on Debt Service Limit. The loan amount supported by the applicable percentage of the projects’ estimated net income. The NOI used to support this mortgage criterion may be split into two or more income streams, for example to capitalize the savings from tax abatement or to recognize other revenue sources such as from an IRP decoupling or the difference between market rents and HAP contract rents.

1) That portion of the maximum mortgage supported by the tax abatement or other source must be amortized over the same period as the additional NOI is available.
2) In order to be recognized in the mortgage proceeds, any tax abatement must run with the real estate and not with the type of sponsorship.

2. Substantial Rehabilitation Loan Limits. Amount of Loan. Rehabilitation under Section 220 and 221(d). (This includes only projects involving substantial rehabilitation.) The insurable loan amount is the lowest of four criteria on Form HUD-92264-A, Supplement to Project Analysis: the application amount, the cost amount, the statutory limits amount or the debt service amount, as described below. Refer to Chapter 3 for the applicable program required maximum loan ratios and the debt service coverage ratios needed to complete the criteria for substantial rehabilitation Firm Commitment applications.

a. The Application amounts.

b. The lender’s estimate of the rehabilitation cost plus the “as is” value of the land and existing improvements before rehabilitation, multiplied by the applicable percentages in Chapter 3.

c. Amount of Loan – Rehabilitation under Section 231. (Only for projects involving substantial rehabilitation.) The amount as permitted under the new construction program except the loan limitation is based on the estimate of value rather than the replacement cost. The insurable amount is the lowest of:

1) The application amounts.
2) Property owned – 100% of the estimated cost of rehabilitation plus the lesser of:

(a) Principal amount of existing indebtedness against the property and closing charges, or
(b) For all borrowers, apply the amounts in Chapter 3, to calculate the lender’s estimated appraised value of the property before rehabilitation and closing charges less:

(i) Value of leased fee, if leasehold, and/or
(ii) Principal amount of special assessment

3) Property to be acquired – For all borrowers apply the amounts in Chapter 3 to calculate the lender’s estimated current cost of rehabilitation/reconstruction plus the lesser of:

(a) Apply the amounts in Chapter 3 for all borrowers to calculate the actual purchase price of the property and closing charges, or

(b) For-profit borrowers apply the amounts in Chapter 3, of the lender’s estimated appraised value of the property before rehabilitation and closing charges and/or principal amount of special assessment.

B. Insurance of Advances and Related Matters. See Section 12.7 and Appendix 12 for processing instructions.

8.11 Sections 223(a)(7) and 223(f) Firm Commitment Processing: Determining Mortgage Amounts, Cash Requirements and Related Matters

A. Firm Commitment Processing for Section 207 pursuant to 223(f):

1. Amount of loan in a purchase transaction.

   In a purchase transaction involving an arm’s length sale, the mortgage may not exceed the lowest of 5 criteria on Form HUD-92264-A, Supplement to Project Analysis: the application amount, the loan to value amount, the statutory limits amount, the debt service amount, and the cost amount, which are described below. Refer to Chapter 3 for the applicable maximum loan ratios and the debt service coverage ratios needed to complete criteria for a Firm application for a purchase transaction.

   a. Application amount.

   b. Loan-to-Value Ratio amount. Refer to Chapter 3 for ratios. These loan-to-values apply to both for-profit and nonprofit borrowers. (The amount based on value for Section 202 or 202/8 Direct Loan purchase transactions is 90%).

   c. Statutory Limits Amount. This limit is based on maximum costs. The maximum per family unit limitation for refinance under Section 207 may be increased by the
percentage of the High Cost Percentages (HCP) plus the percentage loan ratio noted in A.1.b, above. Follow the same guidance for in Section 8.10.A.1.c.

**NOTE:** Per family unit limits may be increased by the High Cost Percentages. The per-unit limits and HCP may be obtained on the HUD web site at:


d. Debt Service Amount. Debt service is the loan amount supported by the applicable percentage of the project’s estimated net operating income (NOI). The mortgage may exceed this limit by capitalizing the savings from any tax abatement. In such cases, the net earnings estimate will not reflect that temporary tax abatement.

The NOI used to support this mortgage criterion may be split into two or more income streams to capitalize the savings from tax abatement or to recognize other revenue sources such as from an IRP decoupling or the difference between market rents and HAP contract rents.

1) That portion of the maximum mortgage supported by the tax abatement or other source of revenue must be amortized over the same period as the additional NOI is available.

2) Any tax abatement must run with the real estate and not with the type of sponsorship if it will be recognized in the mortgage proceeds.

e. Acquisition Cost. The applicable percentage from Appendix 3B must be applied to the Borrower’s acquisition cost. Acquisition cost is defined as the sum of the items:

1) Purchase price shown in the purchase agreement and determined allowable by the lender.

2) The lender’s estimate of repair cost, if any, provided such costs are paid by the Borrower and are not included in the purchase price.

3) The sum of reasonable financing charges, legal, organizational, and title and recording expenses paid by the Borrower.

4) Eligible discounts paid by the Borrower at property acquisition.

**NOTE:** Any fees, discounts or other amounts paid by the seller for or on behalf of the purchaser must be reflected as a reduction to the acquisition cost.

1) Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable, and other fees as may be determined eligible by the lender including the cost of lender third party reports.

2. Amount of Loan in a Refinancing Transaction.

The subject loan will be the lesser of a or b:
a. Amounts in Section 8.11.A.1 above, except e.

b. Cost to Refinance. An amount that equals the greater of the following:
   1) 80% of the lender's estimate of the value of the project, or
   2) The cost to refinance the project, which is defined as the sum of:
      i. The amount needed to pay off the existing indebtedness as determined eligible by the lender.
      ii. The initial deposit to the Reserve for Replacements.
      iii. The sum of reasonable financing charges, legal and organizational, and title and recording expenses paid by the Borrower.
      iv. The lender’s estimate of repair cost, if any.
      v. Eligible discounts paid by the Borrower.
      vi. Eligible architect's fees, mechanical engineering fees, municipal inspection fees, HUD inspection fees, if applicable, and other fees as may be determined eligible by the lender including the cost of lender third party reports.
      vii. Less the amount of any Reserve escrow for replacement and/or major movable equipment that will be purchased as an asset of the project.

c. Cash-Out / Equity from Loan Proceeds.
   The maximum loan-to-value ratio for cash-out refinances is 80%. In cases where the completion of repairs is deferred (non-critical repairs) and the mortgage amount exceeds the costs of refinancing and all required costs including repairs (“cash-out transaction”), the Lender must withhold fifty percent (50%) of the cash-out proceeds in a dedicated account until all repairs are completed in a manner acceptable to the MAP Lender and HUD. Waivers requesting a reduction in the holdback amount will be considered only when the holdback is greater than $1,000,000 for both the estimated repair cost and the assurance of completion escrow. A reduction in the holdback to an amount less than $1,000,000 will be considered only if (1) the non-critical repairs are minimal, (2) the owner has demonstrated both the ability to complete repairs in a timely manner and a commitment to keeping the property in good repair with no deferred maintenance; and (3) that any reduction in the holdback below the $1,000,000 threshold represents no risk to HUD.

   Critical repairs are not subject to this cash-out or withholding of proceeds. Critical repairs are completed before Initial/Final Endorsement and are not deferred. Refer to Chapter 12 Section 12.17 to see the guidance on when and how repair funds are released from escrow.

d. Funding Repair Escrow and an Additional Assurance of Completion (Escrow Agreement for Deferred Repairs (Form HUD-92476.1M (6/2018)).

   1) 100% cash escrow equal to the total cost of estimated repairs must be established and withheld in cash from mortgage proceeds to cover the total cost of the estimated repairs (non-critical repairs/deferred repairs) identified in the CNA (Section 5.10.L) for completion after endorsement.
2) Additional escrow for an assurance of completion is a percentage of the repair cost. The additional escrow is broken down as follows:
   i. Section 223(f) 20% in cash or letter of credit,
   ii. Section 223(a)(7) 10% in cash or letter of credit, and
   iii. For Tax Credits 10% tax credit equity or letter of credit.

B. Identity of Interest Purchase Transaction.
   Refer to Section 13.16.

C. Determining Existing Indebtedness in a Refinancing Transaction.

Existing indebtedness in a refinancing transaction is defined as:
1. Outstanding mortgage(s) incurred in connection with the construction or acquisition of the project or with capital improvements made to the property, as confirmed by the current mortgagee. Use the pay-off letter located in Appendix 8E of this Guide to record amounts.
2. Other recorded indebtedness such as mechanic’s liens and tax liens, provided the liens do not result from personal obligations of the Borrower.
3. Unrecorded debt directly connected with the project supported by documentation from the Borrower. For such debt to be recognized, the Borrower must provide the lender with documentation that unquestionably identifies the indebtedness with the project and is not the result of unpaid operational expenses such as delinquent interest, accounts payable or deferred management fee. Examples are:
   a. Prepayment penalties on the mortgage.
   b. Indebtedness incurred in making significant betterments to the property.

NOTE: Program penalties arising from the defeasance of tax-exempt and taxable bonds, and greater than 10% of the proposed FHA insured loan amount cannot be recognized. Similarly, the costs of settling prepayment penalties or yield maintenance fees associated with swaps or other derivatives (e.g., swap breakage fees) greater than 10% of the proposed FHA insured loan amount are not eligible to be included in the calculation of existing indebtedness. Prepayment penalty, defeasance costs and/or the costs associated with prepayment of derivative instruments which are greater than 10% of the proposed FHA insured loan amount may be paid only from equity out (i.e. when the loan amount is 80% of LTV or less on a Section 223(f) refinancing).

4. Mezzanine Debt. Mezzanine debt may be considered in the eligible basis for refinancing only where there is no identity of interest between the principals and the Mezzanine lender or any affiliates of either party, or in cases where the funds were used to fund capital improvements.

5. Do not recognize indebtedness:
a. Recently placed against the project to increase the mortgage or circumvent program intent.

**NOTE:** “Recent indebtedness” for multifamily properties is defined as any debt incurred up to 1 year before the submission of an application for mortgage. Recent indebtedness can be recognized only if it was used for a non-entity of interest acquisition, for construction, or capital improvements to an existing project. Bridge loans to retire maturing debt used for such purposes are acceptable. The Borrower must provide sufficient documentation that supports recent indebtedness.

b. Created by wrap mortgages:

1) The Borrower and lender must give a detailed explanation of the purpose of the wrap and a documented accounting of the use and disbursement of the loan proceeds.

2) The lender may recognize loan proceeds used for capital improvements or project operations.

D. Reserve for Replacements.

The cost of an initial deposit to the Reserve for Replacements is eligible for inclusion in the maximum insurable mortgage.

1. Purchase Transaction.

a. The purchase agreement must specify:

1) Whether or not the transfer includes the Reserve for Replacements or other escrows as an asset of the project.

2) Dollar amounts of escrow and/or items which the seller will pay on behalf of the Borrower, e.g., the operating deficit, discounts, initial deposit to the Reserve for Replacements.

b. Apply existing Reserve funds transferred as an asset of the project as a reduction of acquisition cost when computing Criterion 7 on Form HUD 92264-A.

2. Refinancing Transaction.

a. The Borrower must submit a list of escrows currently on deposit with the project. This applies to both FHA insured and non-insured projects. Details of the disposition of escrow funds will depend on the type and terms of the transaction and the specific escrow account.

b. The real estate tax and insurance escrow account and Reserve for Replacements (RFR) must remain with the project.
c. The balance of the existing RFR is applied to fund the initial deposit to the reserve for replacement (IDRR). Any excess is applied as a reduction to the cost of refinancing under criterion 10 on Form HUD 92264-A, or as an additional source of funds.

E. Discounts and/or Costs of Issuance associated with bond financing may be eligible for inclusion in the computation of Criteria 7 and 10. See Chapter 3 for further details.

8.12 Firm Commitment Processing with Grants and Loans

A. In General.
These instructions apply to:
1. Grants and loans to the Borrower or its Principals from a federal, state or local government agency or instrumentality.
2. Grants and loans to the borrower or its Principals from national, regional and local community service organizations (nongovernmental source) or foundations.
3. Refer to Chapter 14 for guidance on LIHTC, Historic Tax Credit and New Markets Tax Credit equity syndication proceeds.

B. Application for Mortgage Insurance.
1. At the Firm Commitment processing stage, the applicant must:
   a. Identify the use of grant/loan funds on Form HUD-92013, Application for Project Mortgage Insurance.
   b. Submit: A commitment letter signed by an authorized agent of the governmental agency or instrumentality or the non-government source identifying:
      (a) Amount of grant/loan funds including all repayment terms and conditions and any regulatory restrictions that affect the operation of the property.
      (b) Intended use of the grant/loan funds.
      (c) Any conditions to the grant/loan and any reasons the commitment letter could be withdrawn.
      (d) That the grant/loan is not subject to a future appropriation or funding availability that is not currently in the hands of and available for disbursement by the governmental agency or instrumentality or the non-government source.

2. Any type of grant/loan not disclosed by the Borrower may result in a rejected application or the issued Firm Commitment made null and void.

C. Grants/Loans from governmental agency or instrumentality.
1. Firm Commitment. HUD will review the proposed grant/loan structure, terms and conditions and the draft grant/loan documents during Firm Commitment processing or
earlier, as needed. HUD will consider waivers with reasonable terms in order to facilitate coordination between FHA requirements and those of the governmental agencies.

2. Initial Endorsement
   a. Before scheduling the closing, Field Counsel must review the grant/loan documents to assure their legal sufficiency.
   b. The MAP Lender must consent in writing to the placing of the subordinate mortgage and agree that its existence could not create a basis for default on the first mortgage.
   c. The governmental secondary financing lender must enter into the HUD prescribed form of Subordination Agreement.
   d. The Borrower, instead of that portion of the front money escrow provided by the grant/loan, may use either:

      1) An unconditional irrevocable letter of credit issued by a banking institution with a rating acceptable to HUD and for a term acceptable to HUD; or
      2) An agreement between the governmental agency or instrumentality, the MAP Lender and the Borrower, which provides the following:

         (a) MAP Lender has:
            i. The right to approve construction advances after considering any reported noncompliance by the agency or instrumentality if the project is proceeding in compliance with approved plans and specifications.
            ii. A joint review and agreement between the MAP Lender, and the governmental agency or instrumentality on the construction progress schedules and allocation of draws.
            iii. Sole authority to resolve differences in the inspection process and the process of disbursing grant/loan proceeds.

         (b) The MAP Lender will furnish both HUD and the governmental agency with copies of the approved interim advances Form HUD-92448, Contractor’s Requisition, Form HUD-92403, Application for Insurance of Advances of Mortgage Proceeds, and supporting documentation. HUD approves the initial and final advances.

         (c) The governmental agency or instrumentality must process the advance from its grant or loan funding promptly and without adjustment. HUD or the MAP Lender will:
            (i) Send the governmental agency a copy of the approved requisition for its records.
            (ii) The governmental agency must notify HUD and the lender of a need to make an adjustment the following month.
(d) The governmental agency assumes the risk for any grant/loan funds disbursed in excess of the amount approved by HUD or the lender and agrees to replenish the excess funds within 10 working days of notification by HUD or the lender.

(e) If a default occurs before completion of construction, the governmental agency must disburse the remaining grant/loan funds so long as the request for funds remains in the same ratio as previously authorized.

(f) administrations.

3. Grant/loan proceeds must be advanced either:
   1) Before the insured mortgage proceeds, or
   2) Concurrently and on a pro rata basis with the disbursement of the insured mortgage proceeds.

   NOTE: If the grant/loan proceeds are not available at initial endorsement, HUD may either:
   a) Proceed to initial endorsement, but not disburse any insured mortgage proceeds until the grant/loan is in place and the funds are available for disbursement, or
   b) Recommend the Borrower/Sponsor fund an escrow equal to the grant/loan.
   Advances from this escrow must follow outstanding instructions for the disbursement of the grant/loan.
   3) Release of grant/loan proceeds cannot be conditioned on the completion of specific project improvements.

4. See Appendix 12A for front money requirements and disbursement of mortgage proceeds on LIHTC projects.

D. Grants/Loans from a non-governmental source.

1. Commitment Processing.
   a. The last 3 years of audited financial statements, if available, must be submitted evidencing that the providing source has the financial capacity to meet its funding commitment.
   b. If audited financial statements are not available, unaudited statements meeting the requirements of Section 8.4.C must be provided.

2. Initial Endorsement.
   a. Before scheduling the closing, HUD must review the grant/loan documents to assure the legal sufficiency of the documents.
   b. The grant/loan funds must be disbursed before insured mortgage proceeds.
   c. Release of grant/loan proceeds cannot be conditioned on the completion of specific project improvements.

3. All work performed with the grant/loan proceeds:
   a. Must be cost certified.
b. Must conform to Davis-Bacon requirements including submission of payrolls, certifications, etc., if payment of Davis-Bacon wage rates is required by the grant/loan program.

8.13 Insurance Upon Completion

Insurance Upon Completion (IUC) is an option for new construction and substantial rehabilitation projects financed under Sections 220, 221(d)(4), and 231. Mortgage insurance is provided after project completion and issuance of Certificates of Occupancy for all units. The following instructions apply to IUC projects:

A. A financial and credit investigation is required on the Borrower, its Principals and any identity of interest general contractor.

B. MIP is not included in Form HUD-92264 nor is it charged until the project reaches endorsement.

C. Working Capital and Operating Deficit Escrows. Projects that apply under IUC must meet the operating deficit escrow and working capital requirements as outlined in Section 8.14 below, except for the extra 2% construction contingency portion of the working capital, which is not required.

D. Assurance of Completion is not applicable to IUC projects. However, at endorsement, the general contractor must address latent defects by completing the Latent Defects Escrow, Form HUD-92414M. An escrow of 2½% of the total amount of the construction contract in the form of a surety bond, cash escrow, or an irrevocable letter of credit issued by a banking institution is required at endorsement. (See Section 12.16 S Builder’s Warranty)

E. Breakdown of Financing Charges: In IUC projects, before issuance of the Firm Commitment.
   1. The mortgagee must provide:
      a. A breakdown of financing charges and discounts by submitting Form HUD-92455M Request for Endorsement of Credit Instrument, Certificate of Mortgagee, Borrower and General Contractor, with the Certificate of Mortgagee portion completed. The balance of the Form is to be completed before Final Endorsement in lieu of Form HUD-92023M.
      b. Information relative to the construction and permanent interest rates and mortgage term.
   2. Each item is reviewed to ensure its reasonableness in relation to comparable projects and market conditions.
   3. HUD will inform the borrower of the fees that are recognizable for cost certification.

F. Building Loan Agreement, Form HUD-92441M, is not applicable to IUC projects.
8.14 Determining the Estimated Cash Requirements for Completing the Project

The MAP Lender has the obligation to collect and hold all funds, escrows, and deposits (initial draw, mortgage proceeds) specified for the transaction; this includes all other funds held by or at the order of the lender in connection with the loan transaction. All funds are held by the lender or a depository institution satisfactory to the lender and must be pursuant to any applicable escrow agreement(s).

The MAP Lender must evaluate the Borrower’s and its Principals’ financial strength and creditworthiness, including their ability to meet the financial requirements for completing a project. The lender’s underwriter is responsible for completing the Form HUD-92264-A and the electronic wheelbarrow to present their analysis of cash requirement to close the transaction.

To calculate the financial requirements, the lender must total the following:

A. Total estimated development cost, including the amount by which the:
   1. Contractor’s and/or Borrower’s estimate for construction exceeds lender’s estimate;
   2. Owner/Architect Agreement for design and/or supervisory services exceeds lender’s estimate; or
   3. Consultant’s contract for services exceeds lenders estimate.

B. Amount necessary to clear all debts on the land (or property if substantial rehabilitation). The lender must verify all indebtedness that must be paid off at endorsement. In purchase transactions, include other costs associated with the acquisition that will not be recoverable from mortgage proceeds, such as zoning expenses.

C. Estimated cost of offsite improvements and demolition.

D. Cost of equipping and furnishing a project with non-realty items, if applicable. Use the higher of lender’s estimate or the Borrower’s estimate.

E. Working capital deposit, if required.
   1. The working capital escrow requirement for new construction transactions is 4% of the mortgage amount, half of which is a construction contingency for cost overruns and approved change orders. Separate provisions within the working capital escrow will govern the remaining 2% construction contingency. Any unused portion of the construction contingency escrow is refunded to the developer at Final Endorsement. Construction funded from the contingency portion of the working capital escrow may be considered as the basis for a request for an increased mortgage amount. A waiver of the 2% Working Capital Escrow requirement for substantial rehabilitation transactions with Section 8 rental assistance and LIHTC restrictions covering more than 90% of the units.
may be granted when the Lender is able to demonstrate there will be enough income generated by the project during the rehabilitation period to cover items typically funded by the Working Capital Escrow. See Section 3.2.J of the MAP Guide.

2. Working capital funds are not mortgageable and the unused portion may be released to the Borrower. See Chapter 12 Section 12.15.D for release of the escrow.

3. The working capital escrow requirement for substantial rehabilitation projects is 2% of the mortgage amount.

4. Use Form HUD-92412-M, Escrow Agreement for Working Capital. The lender will deposit said funds in an account insured or guaranteed by a federal agency. See Handbooks 4350.4, Insured Multifamily Mortgagee Servicing and Regional Office Director/PC for the depository requirements.

F. Operating deficit escrow.

1. For all new construction and for substantial rehabilitation projects in which there will be significant resident displacement resulting in negative cash flow during the rehabilitation period, the operating deficit escrow will be the greater of:

   a. What the appraisal and underwriting analysis determines to be appropriate; or

   b. 3% of the mortgage amount; or

   c. 4 months debt service (Principal & Interest and Mortgage Insurance Premium) if the property is a garden apartment, or 6 months debt service (Principal & Interest and Mortgage Insurance Premium) if the property is an elevator building where a single Certificate of Occupancy will be issued before any of the units or any of the entire floors can be rented.

2. HUD will consider lender requests for operating deficit escrow draws during lease-up based on the adequacy of the remaining amount of operating deficit escrow on deposit with the project. See Section 12.15.E for further mitigation and release guidance.

3. The amount of the operating deficit escrow for substantial rehabilitation projects with at least 90% Project-Based Rental Assistance shall be based only upon the conclusions of the appraisal and underwriting analysis and need not be the higher of 3% of the mortgage amount or 4 months of debt service. The underwriting presentation should provide a detailed estimate of the projected cash flow through the period of the rehabilitation to support the lower escrow amount.

4. Use Form HUD-92476a-M, Escrow Agreement for Operating Deficit. The lender will deposit said funds in an account insured or guaranteed by a federal agency. See Handbook
4350.4, Insured Multifamily Mortgagee Servicing and Regional/Satellite Office for the
depository requirements.

G. Commitment, marketing fees, and discounts must be paid out-of-pocket by the
Sponsor/Borrower and may not be paid from the operating deficit escrow.

H. For tax-exempt or taxable bond financing, cost of issuance must be paid out-of-pocket by the
Sponsor/Borrower and may not be paid from the operating deficit escrow.

I. The operating deficit escrow may be used to pay relocation expense that was not included in
MAP Lender’s estimated replacement cost on Form HUD-92264-A.

J. Calculate the cash investment required. The lender must deduct from the estimated development
cost: the maximum insurable mortgage, any grant/loan funds or tax credit equity attributable to
replacement cost items, and fees not to be paid in cash. The remaining balance is the estimated
financial requirements to complete the project. Record this calculation on Form HUD-92264-A
Line 7.

K. Cash-Out Escrow from Land Equity.
   If land, or the “as is” property value for a substantial rehabilitation project, is contributed to
meet the Borrower’s equity requirement, any cash-out from the excess land or property equity
above what is required at initial endorsement must be deferred until the project is complete and
has demonstrated to the satisfaction of the Regional Office that it has achieved 6 consecutive
months of break-even occupancy or 12 months break-even occupancy for transactions meeting
Large Loan parameters. At initial endorsement the lender will establish an escrow, and the
balance thereof can be released to the Borrower after the deferral period. This does not prevent
the Borrower from applying land value equity to fund the operating deficit, the working capital
escrow, or other (i.e. non-mortgageable) cash requirements at initial endorsement. To the
extent that there are excess mortgage proceeds available from the land value (or “as is value”)
or other equity, and after capitalizing the required escrows etc., any remaining balance of
excess mortgage proceeds may also be used for all the purposes described in Appendix 12A,
paragraph D. This includes funding the working capital construction contingency escrow. See
Sections 12.8 and 12.15 for specific guidance. After all escrows and cash requirements are
established at initial endorsement, any balance remaining in the land escrow is deferred until
operations of the project have achieved 6 consecutive months of break-even occupancy. After
this period the balance of the escrow may be released to the borrower at the later of Final
Endorsement or where the project is not in default. (See Section 12.15.C for working capital
details and 12.15.D for the IOD details.).

L. Employment-Based Fifth Preference: EB-5 Equity Source.
   EB-5 is a U.S. Citizenship and Immigration Services (USCIS) program created in 1990 to
stimulate the U.S. economy through job creation and capital investment by foreign investors
and is used to raise equity. See the U.S. Citizenship and Immigration Services (USCIS) website at: https://www.uscis.gov/eb-5. Any contribution of EB-5 equity must be available at the time of initial closing, therefore, an equity deferred pay-in schedule cannot be applied:

a. Projects that propose EB-5 investments as debt rather than equity are subject to the limitations on secondary financing. HUD will only consider waivers if there are significant affordable rent and income restrictions and there is some public interest motivation (beyond the EB-5 program incentive itself.)

M. Assurance of Completion.

1. Performance Bond and Payment Bond. The general contractor must provide for the protection of HUD and lender and to meet state and local requirements protecting material suppliers, mechanics, and subcontractors. The general contractor’s assurance of completion must provide:

a. For non-elevator buildings, or elevator buildings with four (4) stories or less, where the cost of construction or rehabilitation is more than $500,000, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD’s estimated cost of construction or rehabilitation including an assumed builder's profit on BSPRA transactions (see Section G Line 50, Form HUD-92246, less architect’s design and supervisory fee and mortgagor’s other fees). Alternatively, the completion assurance agreement may be secured by a cash deposit or Letter of Credit in the amount of 15% of the HUD estimated cost of construction or rehabilitation.

b. For elevator buildings of five (5) stories or more, the assurance shall be in the form of corporate surety bonds for payment and performance, each in the amount of 100% of HUD’s estimated cost of construction or rehabilitation including an imposed builder's profit on BSPRA transactions. Alternatively, the completion assurance agreement may be secured by a cash deposit or Letter of Credit in the amount of 25% of the HUD estimated cost of construction or rehabilitation.

c. The Completion Assurance Agreement – Form HUD-92450 is secured by a cash deposit (or unconditional, irrevocable letter of credit).

8.15 Bond Financed Projects/ Tax-Exempt Agency Loans

A. Review of Financing Documents. A tax-exempt bond is a security issued by a governmental agency in which the interest income produced is free from federal income tax and sometimes free from state and/or local income tax. In addition, many public agencies may make tax-
exempt loans under the same principals without the issuance of bonds. Financing documents associated with mortgage bonds or tax-exempt bonds and loans are prepared and reviewed by the issuer, their counsel and, with respect to bonds, the bond underwriter and their counsel. The tax-exempt loan and/or bonds are secured by one or more assets, which may be cash, a letter of credit, GNMA mortgage-backed security issued by the lender (Ginnie Mae Security), and/or a mortgage. In FHA insured transactions, these tax-exempt loans and bonds are typically backed by cash collateral held by the trustee, or by the Ginnie Mae Security, but may also be backed indirectly by an interest in the insured loan.

1. The Sponsor must submit, with the application for Commitment processing, a separate statement itemizing the estimated costs of issuance, fees and discounts and financing fees for the tax-exempt loan or bond to be paid out of pocket by the Sponsor/Borrower with an explanation of the necessity and reasonableness of each cost. The lender’s underwriter must check the statement for reasonableness, using the data from previously processed tax-exempted financed projects and adjust costs where appropriate. This information is used to develop the Total Estimated Cash Requirement Form HUD-92264-A, Supplement to Project Analysis.

B. Loan Rates.

1. The construction loan and the permanent loan rates may exceed the interest rate on the bond obligations. When this occurs, the spread will create a surplus of funds which must be held by the bond trustee. At initial closing, the bond counsel must supply HUD with a legal opinion that any investment income received by the mortgagee but not held for its own account must be under the control of the trustee or agent holding the product funds relating to the tax-exempt financing and will not flow through the books and records of the project. The tax-exempt financing documents will instruct the holder of the projects funds to invest the funds in a federally-insured interest bearing account, submit the project’s financial statement, or permit the Borrower to use the surplus of funds to cover costs associated with the tax-exempt financing transaction.

2. In all cases, the interest rate on the tax-exempt financing will not be known during the Commitment processing, therefore the underwritten rate will almost certainly change once the tax-exempt interest rate has been established (e.g. the sale of the bonds). Upon determination of the mortgage rate, an amendment letter to the Firm Commitment will be issued reflecting the actual interest rate. If, due to time constraints, HUD does not have sufficient time to reprocess a higher mortgage for the project, the Firm Commitment must contain the following condition:

“Any interest savings resulting purely from a differential between the HUD-processed interest rate and the actual, final interest rate may not be construed as excess funds that
may be used to offset costs in other categories at the time of cost certification. Any such savings must be applied as a mortgage reduction.”

**NOTE:** An exception to the above is that savings resulting from the early completion of construction may be used to offset cost certifiable overruns in other cost categories. Compute interest savings by:

a. Recalculating the interest line item on Form HUD-92264, using the actual interest rate for the scheduled construction period.

b. Subtracting the actual interest cost recognized at cost certification from the revised interest figure developed in (1) above.

c. HUD will allow a total financing and placement fee of 5.5% on tax-exempt financing applications. This limit applies to all multifamily Sections of the Act except Section 223(a)(7) and is reflected in the replacement cost mortgage amount confirmed at cost certification.

C. Tax-exempt loans and/or bonds may be sold at a premium to investors, whereby the investor pays an amount in excess of the face value of the tax-exempt loans and/or bonds. The premium results from the tax-exempt financing carrying a higher rate than is generally available in the marketplace.

1. Any premium raised by a transaction is considered part of the mortgagee, bond underwriter, and/or issuer’s profit, as applicable. However, if a mortgagee gives something of value without the expectation of being repaid, HUD considers this to be a kickback. The one exception involves tax-exempt financing transactions where the issuer of loans and/or bonds permits the Borrower to receive some portion of the premium to offset the cost of issuance so that the mortgagee, bond underwriter and/or issuer, as applicable are simply conduits for the transfer of funds.

2. If any of the premium is remitted to the Borrower, it will be considered excess investment income, treated as project income, and used to reduce the total allowable cost of the project.

3. On tax-exempt financed projects, the premiums may be treated as project income under the following conditions:

   a. The Sponsor/Borrower cannot benefit monetarily from the excess investment income.

   b. The premium, if accessible to or given to the Sponsor/Borrower, is considered as excess investment income.

   c. Closing documents must detail the amount of the premium being given to the Sponsor/Borrower.
d. The premium may be used to pay for additional cost associated with the cost of issuance and may be applied to other recognizable cost overruns.

e. The Borrower’s accountant or the Borrower must detail in the notes to the financial statement the amount of excess income received.

4. For nonprofit applications, excess income generated from premiums may be applied to recognizable cost overruns. Any excess income over and above that used towards recognizable cost overruns must be transferred to the reserve for replacement account.

5. On Section 223(f) applications, excess income generated from premiums must be transferred to the Reserve for Replacement account.

D. Itemized Statement of Costs. An itemized statement of the costs of issuance of the obligations, discounts and financing fees paid through the mortgagee must be attached to and reflected in the Lender’s Certificate, Form HUD-92434M.

1. The statement must detail the use of each individual item necessary for the issuance of the obligations.

2. The lender must review the amount of each item to ensure its reasonableness in relation to comparable projects.

3. A letter from the Regional Office Director will inform the mortgagee that HUD will recognize for cost certification purposes the costs of issuance, discounts and financing fees in an aggregate amount not to exceed 5.5% of the insured loan amount, which may be included in the mortgage for all programs (except Section 223(a)(7)).

4. The mortgagee, bond underwriter, and/or issuer, as applicable have the option of deferring collection of additional discounts, financing fees, slow draw fees, etc., through the provision of Paragraph 20(G) of the Lender’s Certificate (Form HUD-92434M).

a. The deferred collection of these items must be an obligation of a third party. Each of the third party and the mortgagee’s bond underwriter, and/or issuer, as applicable must attest in writing that they will not look for payment from the:

1) Borrower,
2) Mortgaged property,
3) Mortgage proceeds,
4) Any reserve or deposit required by HUD and/or the mortgagee in connection with the insured mortgage transaction; or
5) Rents or other income from the mortgaged property.
b. The Borrower may (but is not required to) issue, as evidence of the debt, promissory
note to the third party for costs identified in this paragraph which contains surplus cash
limitations and which HUD otherwise determines to be reasonable.

E. State and Local Tax-Exempt Financed Projects.

1. Prepayment of Note. State and local bond financed projects are subject to prepayment
restrictions and penalty charges as provided in Chapter 11 Section 11.8.B.3. However, in
the case of so-called short-term cash-collateralized tax-exempt financing issued in
conjunction with an allocation of 4 percent LIHTCs, the tax-exempt financing is non-
recourse to the borrower and the financing is fully secured by cash collateral or an interest
in project loan documents, and will mature shortly after construction completion (for
construction loans) or project repairs (for projects insured under Sections 207/223(f) and
223(a)(7)). In such cases, the tax-exempt financing documents, which may include
promissory note, loan agreements, collateral agreements, etc.) are generally not subject to
HUD’s requirements for secondary financing unless the short term cash-collateralized tax-
exempt bonds are secured against the insured project using a recorded Bond Mortgage.

2. State/Local Occupancy Use and/or Rent Restrictions. Use or rent restrictions sought by
the State or local jurisdiction for projects financed by proceeds from State/local tax-exempt
obligations are often more restrictive than the minimum requirements of the Internal
Revenue Code. The Regional/Satellite Office Director may approve a State or local
restriction exceeding the minimum requirements of the Internal Revenue Code, but only if
the following conditions are met:

a. The Regional/Satellite Office Director must determine that the restriction is not likely
to have an adverse impact on project occupancy, marketability or long-term feasibility.
This determination must be made on a project-by-project basis.

b. The restriction must not conflict with any applicable HUD mortgage insurance
regulations or related administrative requirements.

c. The restriction must not appear in the Note, Mortgage, Regulatory Agreement or any
other HUD/FHA loan document.

d. Unless otherwise approved in writing by HUD, the restriction must be qualified to
provide that it will automatically terminate in the event of either foreclosure or transfer
of title by deed in lieu of foreclosure. Such a termination provision must be included in
every legal instrument (e.g., deed, land use restriction agreement, Security Agreement,
or financing agreement) in which the restriction appears.

F. Pre-Cost Certification Conference Information. The lender must demonstrate at the pre-cost
certification conference that:

1. The net cost of negative arbitrage (i.e.: the tax-exempt escrow account yield vs. capitalized
interest expense) may be recognized if there are offsetting savings in the mortgage.
2. Any rebate to the Sponsor/Borrower from the mortgagee, issuer or bond underwriter, as applicable, will reduce the mortgageable cost certification. The following are two samples of the most common types of rebates.

   a. If mortgagee/issuer/bond underwriter contributes a portion of the initial service charge that was collected to pay discounts or other fees.
   b. If mortgagee/issuer/bond underwriter refunds a portion of the construction loan interest to the Borrower or Sponsor