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WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

Date: March 11, 2024

Mortgagee Letter 2024-03

TO: All FHA Approved Multifamily Mortgagees

SUBJECT: Revised Criteria for Section 232 Portfolio Corporate Credit Reviews

PURPOSE: This Mortgagee Letter addresses and immediately implements policies with respect to applications for mortgage insurance by portfolio applicants in the FHA Section 232 Mortgage Insurance Program.

EFFECTIVE DATE: This Mortgagee Letter applies to all applications submitted to HUD on or after April 10, 2024.

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I. Background & Overview

This Mortgagee Letter (ML) revises the Department of Housing and Urban Development's (HUD's) policy with respect to mortgage insurance applications in the FHA Section 232 Mortgage Insurance Program by applicants with multiple FHA-insured mortgage loans (portfolios). This ML supersedes corresponding previous corporate credit review (CCR) guidance in HUD Handbook 4232.1, Section II Chapter 17 Portfolios.

In 2001, via Notice H 01-03, HUD introduced a corporate credit review process for midsize and large portfolios to assess the credit risk of the parent corporate or holding entity. HUD has always required that a lender submit a separate mortgage insurance application for each facility and that each project individually meet HUD's underwriting requirements. Additionally, HUD determined that portfolio applicants must also be evaluated for their overall financial, operational, regulatory and legal condition to ensure that both the owners and operators have the experience and financial strength to successfully operate a portfolio of residential healthcare facilities.

Portfolio Corporate Credit Reviews (CCR) and master leases (see Section 232 Handbook, Production, Chapter 13) are the primary tools HUD's Office of Residential Care Facilities (ORCF) uses to identify and mitigate concentration risk associated with portfolios.

In recent years, HUD has seen an increase in the number of residential care facility loan applications with common owners and related or non-related operators. Related entities with multiple insured loans pose potential concentration risk for FHA. Historically, ORCF has evaluated applicants at each portfolio tier in the same manner based solely on the aggregate UPB of their insured Section 232 mortgages. However, HUD has determined that a more nuanced treatment is necessary so that those portfolios which pose the greatest potential risks to FHA and its insurance fund receive a more extensive evaluation prior to receiving FHA mortgage insurance. For example, in certain circumstances a non-operator owner may present less risk than a related owner-operator. Therefore, ORCF's approach to risk analysis for portfolios will now be based on an assessment of: (1) the relative size of the portfolio compared to the overall Section 232 portfolio's unpaid principal balance (UPB), and (2) the portfolio's owner/operator relationship.

Finally, owners and operators whose portfolio UPBs constitute a significant percentage of the total UPB for the entire Section 232 portfolio have not been subject to ongoing enterprise-level updates with ORCF if they are not actively applying for new FHA-insured financing. The lack of ongoing communication with such entities can present unexpected risks to HUD when owners and operators experience financial challenges. Therefore, HUD will now require periodic enterprise-level financial and management updates for portfolios for the duration of the terms of their FHA-insured mortgage loans.

II. Terms and Concepts

Portfolio: Two or more borrower entities that are under common ownership and/or common control.

Common Control: Means two or more entities (Borrower, Operator, Management Agent or Consultant) are owned or controlled, directly or indirectly and solely or in part, by the same individual(s), principal(s) or entity(ies). Affiliated residential care facilities will be grouped into a portfolio if they share common control as defined here. Control of entities is defined at 24 CFR 200.216.

Single Asset Entity (SAE): The Mortgaged Property shall be the only asset of the Borrower and the Operator, except as otherwise permitted by HUD (please see Section 232 Handbook, Production, Chapter 2.5.B and 2.5.C for SAE requirements).

Affiliates/Affiliated: Any person or business concern that directly or indirectly controls the decisions of an entity or has the right to do so.

Portfolio Names: Portfolio names are added to the name of the project for workload tracking in HUD systems so that the individual projects in the portfolio may be tracked together. Identifying a portfolio name allows for more efficient processing of Production applications, as portfolio groups can be readily identified and assigned to the same reviewer. Even if a single application is submitted at a time, if it meets the definition of a portfolio outlined in the Handbook, a portfolio name should be referenced in the FHA Number Request. Portfolio names also assist Asset Management in their overall risk management of the ORCF portfolio by indicating the relationship of individual projects and more effectively assigning the projects to the same Account Executive for oversight.

Controlling Entity: Any entity which directs or has decision making authority of the Borrower, Operator, Management Agent or Consultant, regardless of percentage of ownership interest.

III. Criteria for Corporate Credit Review

A portfolio CCR is required for all Large Portfolios (See Section IV below). Portfolio CCR procedures apply to owners and operators of residential care facilities and their affiliates in the following circumstances:

- 1) An application for mortgage insurance for purchase or refinance of an existing facility, pursuant to Section 223(f);
- 2) An application for mortgage insurance involving new construction or substantial rehabilitation pursuant to Section 232 NC/SR;

- 3) A change in ownership and/or a change of control of Borrower or Operator. This will generally be a change in the lessee of a facility, a change in the operating license holder, and/or a change in the entity that contracts directly with residents. In some circumstances, a management agent may fill one or more of those roles and could trigger a change of control review if the management agent assumes healthcare operational responsibility.

Portfolio reviews are not required for applications under Section 223(a)(7).

IV. Portfolio Size Classifications

Portfolio size classification is based on threshold dollar amounts as compared to HUD’s total UPB of the Section 232 portfolio of active loans.

	Classification Criteria^{1 2}	Corporate Credit Review
Small Portfolios	Up to 1% of UPB for common control Borrower only Up to 0.6% UPB for common control Operator only or Identity-of-Interest Borrower/Operator.	Not Required
Large Portfolios	1%-5% of UPB for common control Borrower only 0.6%-5% of UPB for common control Operator only or Identity-of-Interest Borrower/Operator.	Required

Portfolio CCR and the Certification of Multiple Projects (see Section VI below) are required for all Large Portfolios. CCR and the Certification of Multiple Projects will not be required for Small Portfolios; however, the projects in the Small Portfolio will be required to enter into a master lease covering each project in the portfolio.

CCR Kickoff: Before undergoing full due diligence of a CCR, the lender must schedule a call with the Director of ORCF, or designee, to discuss the proposed portfolio. This call should identify key issues impacting the required due diligence for the CCR and the timing of the review. Further, the lender and ORCF may elect to have an in-person meeting to discuss the portfolio. It is

¹ UPB utilized for purposes of threshold will be set annually in conjunction with HUD’s fiscal year (FY), and is the total UPB for all insured 232 mortgages as of the end of the prior FY.

² The changes to portfolio classification do not replace other risk mitigation requirements such as a Debt Service Reserve, Mortgage Reserve Fund, or other risk mitigation.

highly encouraged that the lender have regular calls with ORCF, during both the CCR and underwriting.

V. Program Areas Responsible for Risk Reviews based on Levels of Exposure

The program areas required to review the risk related to CCR requests are based upon the percentage of HUD's total UPB for the Section 232 portfolio of active loans, as follows:

- 1) All CCR reviews are to be conducted by ORCF program staff. HUD's Office of General Counsel ("OGC") will conduct an advisory review of the CCR to identify potential legal concerns;
- 2) Reviews exceeding 2% of UPB but not more than 5% of UPB are to also be reviewed by HUD's Office of Risk Management ("ORM") for their advisory opinion; and
- 3) The Deputy Assistant Secretary of OHP, or designee, will provide the final decision regarding acceptance of the proposed portfolio based on an assessment of all analyses.

VI. Certification of Multiple Projects

The lender will obtain a Certification of Multiple Projects, such as is found as part of both the form Consolidated Certification—Borrower and form Consolidated Certification—Principal of the Borrower. The Certification of Multiple Projects must include all projects that the borrower and/or principal(s) participate or proposes to participate in and for which Section 232 mortgage insurance is in force or will be sought, or a Change of Participant (CHOP) of an existing FHA-insured Large Portfolio. The purpose of this Certification is to ensure that HUD is fully aware of all residential care facilities that may be submitted as part of a portfolio application and/or any other FHA-insured residential care facilities with principals common to the current application. It is essential that HUD have this information to ensure that applications are processed properly and to ensure accurate classification in the asset management system.

The Certification of Multiple Projects shall provide the following information:

- 1) The number, location, and estimated mortgage amount of all facilities that are or will be included in applications for FHA mortgage insurance;
- 2) Each certifying borrower's, principal's, and/or affiliate's roles in the proposed project(s);
- 3) All current FHA-insured and/or HUD-held loans (include name and FHA loan number) for which the certifier is a borrower, operator, or other principal as defined in Production 6.1, except certifications submitted with a 223(a)(7) application do not need to be included; and
- 4) Provide on the signature page of the Certification of Multiple Projects that the information on the certificate is accurate and include the following: "Anyone who knowingly submits a false claim or makes a false statement is subject to criminal and/or civil penalties, including confinement for up to 30 years, fines, and civil and

administrative penalties. (18 U.S.C. §§ 287, 1001, 1010, 1012, 1014; 31 U.S.C. §§ 3729, 3802).”

- 5) Provide on the signature page of the Certification the following: “This Certification has been made, presented and delivered for the purpose of influencing an official action of the FHA, and of the Commissioner, and may be relied upon by the Commissioner as a true and accurate statement of the facts contained therein.”

For Large Portfolios, submit the Consolidated Certification in the portfolio corporate credit review package. For Small Portfolios, submit the Consolidated Certification with each individual mortgage insurance application.

All applications for financing, refinancing, or change in facility owner and/or Operators of two or more Section 232 projects, or one project where the proposed principals already participate in other properties with mortgage insurance under Section 232, must include the certifications in their submission.

VII. Portfolio Corporate Credit Review Description

To assist ORCF in reviewing Large Portfolio qualifications, the lender must submit the information required for a portfolio corporate credit review. Lenders shall consult with the Director of ORCF, or designee, regarding the financial, legal and organizational structure of a proposed portfolio submission at the beginning of the process of defining the scope of the portfolio corporate credit review. This communication with ORCF is necessary to ensure that the corporate credit review addresses the relevant information and risk factors. ORCF will determine the subject of the portfolio corporate credit review as to the entity (both ownership and operational) that may potentially create a material risk to the projects and to the General Insurance Fund. ORCF will review all materials submitted in the portfolio CCR and determine whether the portfolio is an acceptable risk to the General Insurance Fund based on operation and ownership experience, financial strength, quality indicators, and any pending legal issues, including the jurisdictional regulatory environments.

ORCF will require a mortgage reserve fund for all Large Portfolios and may impose additional requirements and/or limitations on the portfolio, as well as other risk mitigants. These additional requirements may include, for example, reserves for capital improvements, a higher mortgage reserve fund, lower loan-to-value requirements, professional liability insurance reserve funds, third party risk management programs for facility operations and quality of care, and limitations on cash distributions until certain sustained cash flow multiples are met.

The lender may submit applications up to the appropriate Large Portfolio threshold prior to issuance of a portfolio acceptance letter, signed by the Office of Healthcare Programs (OHP) Deputy Assistant Secretary. Such applications must include a mortgage reserve fund and any

other risk mitigants which the lender can reasonably be expected to be required during the portfolio corporate credit review process.

An initial baseline portfolio CCR must contain the information identified in the checklist and be presented following the list included in this letter. There are scenarios where the list of submission materials may be modified based on the nature of the transaction. Refer to Section IX for a description of some common modified scenarios. The complete package must be submitted electronically. If separate hard copies are delivered to HUD, all materials must be labeled and tabbed in accordance with the outline.

The information in this package must be compiled by the borrower or the lender; however, the lender or borrower may engage a public accountant or other consulting firm with appropriate expertise to assist with the compilation of the information. The lender must inform HUD regarding the entity or entities that prepared or substantially assisted in the preparation of the CCR and any relationship that exists between the lender and the other parties preparing the documentation or involved in the transaction. ORCF may provide templates for inputting the portfolio CCR contents as listed in the checklist.

The professional liability insurance (PLI) review and the accounts receivable (A/R) financing review (if applicable) will occur in conjunction with the portfolio CCR.

The principal(s) must have a minimum of ten years relevant industry experience owning and/or operating residential care facilities to qualify for consideration of accumulating an aggregate HUD-insured mortgage portfolio above the threshold for a Large Portfolio (as previously defined).

A Borrower or Operator of a healthcare facility, or principal or affiliate, may not participate in a facility seeking mortgage insurance through the Section 232 program if the Borrower, Operator, principal, or affiliate is currently in bankruptcy or has filed for or emerged from bankruptcy within 5 years of a lender's application for insurance, CHOP, or similar process.

A project in bankruptcy that is acquired by a non-identity-of-interest owner in good standing may be eligible for mortgage insurance, subject to HUD review. HUD will review updated financial information (post-bankruptcy) and the new management team.

VIII. Portfolio Corporate Credit Review Contents

- 1) Corporate Credit Review Checklists: Checklists for the CCR are provided on the Section 232 Program website. It is necessary to differentiate checklists between owners, owner/operators, and operators. Therefore, it may be necessary to complete multiple CCRs checklists based upon the structure of a portfolio.

- 2) Portfolio Executive Summary: The Lender is required to provide a detailed summary of the proposed portfolio. ORCF can provide a sample Lender Narrative template available, if desired. This will ensure a seamless transition to the underwriting of individual applications.
- 3) Previous Participation Assessment: Evaluation of deal participants is an important part of ORCF's credit process. Portfolios will be required to complete this assessment as part of the CCR process.
- 4) In the absence of consolidated corporate financial statements for the entity or entities with Common Control of the Portfolio, the following information on the individuals with Common Control of the Portfolio is required in addition to the items in the CCR checklists:
 - a) The most recent 3 years, completion of the form HUD-92417-ORCF (Personal Financial Statement)
 - b) Personal Credit Report
 - c) Detailed Schedule of Real Estate Owned, including:
 - i) Percent ownership in the borrower and/or operator entity
 - ii) Indicate whether or not the individual is a managing member or controlling participant of the borrower and/or owner entity.
 - iii) For any senior living asset, include the type of facility, number of units/beds, trailing twelve months (TTM) revenue, TTM expense and TTM occupancy, current debt service and TTM debt service coverage ratio, star rating, and operator.
 - d) Identify all interests in HUD-insured assets.
- 5) Documentation of Source of Liquidity: The CCR must contain financial statements from the individual or entity that can provide liquidity to cover any potential interruption in operations.

IX. Documentation to be Submitted in Conjunction With a Portfolio Corporate Credit Review

For those portfolios requiring a portfolio corporate credit review, the submission package must contain the following items in addition to the information required in Section IV above. Please ensure that all materials are labeled, tabbed, and follow this format.

- 1) The relevant Consolidated Certifications.
- 2) Portfolio corporate credit review and all supporting documentation as described in Section VIII.
- 3) Explanation of any intent to reallocate base rent. (Owner may reallocate base rent allocated to each real property covered by a master lease so long as the total aggregate amount of base rent for all the leased premises is not increased).
- 4) Master lease submission for facilities in a portfolio transaction (if available). The current master lease provisions are described in the Section 232 Handbook, Production, Chapter 13.

- 5) Information demonstrating compliance with liability and property insurance requirements. PLI must be in compliance with the Section 232 Handbook, Production, Appendix 14.1 (the PLI review occurs with the portfolio corporate credit review).
- 6) Information demonstrating that A/R financing complies with HUD requirements. (The A/R financing review occurs with the portfolio corporate credit review.)
- 7) Certification that all proposed projects shall meet the Single Asset Borrower Entity standard.
- 8) Financial Statement Certification.
- 9) Certification of No Investigation, Judicial or Administrative Action:

The Borrower and Operator must certify to HUD that the subject of the corporate credit review, a parent, affiliate, any subsidiary thereof, and the operator are not the subject of an ongoing investigation or judicial or administrative action involving any Federal, State, municipal or other regulatory authority, that may have a detrimental impact on the financial condition or jeopardizes any facility's license and/or the provider agreements. Further, the Borrower and Operator must certify to HUD that the subject of the corporate credit review, a parent, affiliate, any subsidiary thereof, and/or the operator are not the subject of a class action lawsuit (certified or potential). Further, the lender will be required to certify at the time of closing that from the date of the portfolio acceptance letter through the date of final closing there have been no material adverse change in the financial or operational position of the portfolio owner and/or operator. OGC will evaluate any active investigations or litigation to determine whether they pose a serious risk to the portfolio such that processing should be discontinued or placed on hold.

- 10) The submission must clearly identify all proposed portfolio projects, including project name, location, FHA number and mortgage amount to be requested, if known. ORCF understands that such a list may be preliminary and subject to change. Also, for ORCF planning purposes, the lender should provide a preliminary schedule and timing of individual application submissions.

X. Modified Corporate Credit Reviews

- 1) Requests for Additional Capacity After an Initial Baseline Corporate Credit Review:
 - a) Less Than or Equal to \$50M Total Additional Capacity
As long as an existing HUD-insured Large Portfolio of loans is in good standing, additional individual applications may be submitted to the queue for underwriting consideration with notice to HUD that they will be added to an existing Large Portfolio provided that the total additional does not exceed \$50M within 18 months of the last Large Portfolio loan closing.
 - b) Greater Than \$50M Total Within Eighteen Months

- i) The lender must submit updates to the checklist materials for the interim period since the previous CCR, including parent financials, description of significant events, or changes to business (e.g. acquisitions, dispositions, regulatory or legal actions, changes in executive management, etc.), and an updated schedule of all facilities owned and/or operated.
 - ii) ORCF will analyze the operator financial statements submitted through the portal and quality of care indicators for each existing HUD-insured facility, Asset Management history, including any late mortgage payments, regulatory agreement violations, DEC referrals, troubled status, etc. and Annual Update Call meeting minutes (see Section X).
- 2) Single Large Loan: A CCR is not required for a single large loan; however, the Director of ORCF, or designee, will review the application package submitted by the lender and a site visit by the ORCF Credit Risk Officer, Production Director, Production Deputy Director and/or Production Workload Manager will be required.
- 3) CHOP: The lender should follow the checklist for submission of items only for the individual(s) and/or entities in the organizational structure that are changing.
- 4) Other Scenarios: Submission materials may vary depending on the nature of the transaction and will be determined by ORCF. Contact the Director of ORCF, or designee for guidance.

XI. Asset Management of Large Portfolios

Ongoing monitoring of Large Portfolios is critical to the success of the General Insurance Fund. Portfolios meeting the above requirements (currently in the Section 232 portfolio and future portfolios) will be subject to the following:

- 1) Annual Update Call³: The call will include certain members of ORCF Leadership and Asset Management and should be attended by the key management team members from the entity, as determined by ORCF. The agenda for the call will, at a minimum, cover the items included on the Corporate Credit Review checklist posted on the Section 232 website. The annual nature of these calls will allow ORCF to maintain current information on the portfolio and will avoid the need for updated CCRs based on an 18-month passage of time between applications. The Annual Update Calls are also required for all portfolios that received a portfolio acceptance letter prior to the effective date of this Mortgagee Letter.
- 2) Participant Change Risk Mitigation. CHOPs that result in a change in one or more Portfolio operators (or in the case of an owner-operated Facility, the owner) will require a more in-depth underwriting review of the proposed participants. Lender Narrative templates (Form

³ Annual update call to be completed within 60 days of anniversary date of CCR approval or other date approved by HUD.

HUD-92266A-ORCF and Form HUD-92266-ORCF) are available on the Section 232 website. Consistent with the Lender Narrative, the lender's ORCF-approved underwriter will be required to complete an analysis of the proposed participants and ensure that they are an appropriate replacement for the existing operator.

Julia R. Gordon
Assistant Secretary for Housing- FHA Commissioner

Date