

Chapter 6  
Participant Credit and  
Financial Review

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**6.1**

**Determining Acceptability of the Borrower,  
Operator, ~~Parent of the Operator,~~ Controlling  
Participants and the General Contractor**

A. ~~Overall Requirements~~

A key component of the underwriting process is to assess the Borrower and/or Operator's ability to manage the development, construction, completion, and successful lease-up of the FHA-insured property. The underwriting of Section 232 projects involves evaluating the experience ~~and~~, financial condition, and character of the Borrower and its principals, the Operator, ~~parent of the Operator~~ Controlling Participants and the general contractor. ~~The FHA lender (the "Lender") must:~~

For purposes of determining credit and financial acceptability, the terms "participant" and "principal" in this chapter will be construed using the same definition as "Controlling Participant", as set forth in 24 C.F.R. §200, Subpart H; Housing Notice H 2016-15, and any successors thereto.

The FHA lender (the "Lender") must:

1. Identify the Borrower, Operator, ~~parent of the Operator,~~ Controlling Participants, general contractor, and each of their respective principals.
2. Analyze the credit worthiness of the ~~borrower entity, and if formed, the principals of the borrower entity, Operator, parent of the Operator~~ Borrower, Operator, Controlling Participants and the general contractor, demonstrating that the participants have honored their legal, financial, and contractual obligations.
3. Analyze the experience, character and qualifications of the Borrower, Operator, ~~parent of the Operator~~ Controlling Participants and general contractor.

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37 4. Determine the financial capability of the Borrower and the general contractor.  
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39 Take a wholistic approach to evaluating credit worthiness and assessing credit or character  
40 risks. ORCF expects the FHA Lender to inquire about and to bring to ORCF's attention any  
41 potential ~~credits~~character risks such as, without limitation, governmental investigations,  
42 criminal proceedings and/or convictions (including ~~convictions resulting from~~ plea  
43 agreements/settlements) or perceived instability in an entity's management structure,  
44 including other business concerns of the principals.  
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46 **B. Terrorism Checks and Verifications**

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48 Terrorism checks and verifications on all principals are required by the USA Patriot Act.  
49 These checks must be completed and documented prior to Initial Endorsement of the FHA-  
50 insured loan, regardless of whether or not the Lender is a regulated financial institution. The  
51 Office of Foreign Assets Control of the United States Department of Treasury administers  
52 and enforces economic and trade sanctions based on USU.S. foreign policy and national  
53 security goals. Information and guidance on the requirements of the Patriot Act can be found  
54 on the Department of Treasury's website: <http://www.ustreas.gov>.  
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56 **C. Identifying principal ownership interest.** ~~There are numerous ways for investors to own~~  
57 ~~an interest in real property.~~ Each form of ownership offers different benefits and risks. If the  
58 Borrower (and/or the Operator and parent of the Operator) has a complex or layered  
59 organizational structure, the Lender must review the structure and identify the individuals or  
60 entities that have control under the organizational structure. The Lender must confirm that  
61 the Borrower (and/or the Operator and parent of the Operator) is legally organized in a  
62 manner that meets U.S. Department of Housing and Urban Development's ("HUD")  
63 requirements for owning and operating an FHA-insured facility; and consider any difficulties  
64 or increased risk that the organizational structure might pose in the event of default or  
65 foreclosure on the FHA-insured mortgage loan. All principals (as defined below in E-4.) are  
66 subject to the disclosure and certification requirements regarding bankruptcy, judgments,  
67 pending litigation and delinquent federal debt. Those principals with decision-making  
68 authority, ~~active management and those in Controlling Participant roles, or a significant~~  
69 ~~percentage of financial investment~~ in the project are subject to a ~~more complete~~ credit  
70 investigation. The Lender is responsible for identifying the principals and the extent of the  
71 credit review required and appropriate for each such principal.  
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73 Individuals who satisfy the Controlling Participant requirement may not be removed from  
74 identified principal or controlling participant entities without prior HUD approval.  
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76 Each FHA-insured property must be owned by a single-asset entity unless another form of  
77 entity is approved prior to application submission (See Production, Chapter 2). The following  
78 types of single asset entities are acceptable:

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1. General Partnership (GP);
  2. Limited Partnership (LP);
  3. Corporation, C corporation, S corporation;
  4. Limited Liability Company (LLC);
  5. Trust;
  6. Non-profit corporation;
  7. Any other public or private single-asset borrower entity; however, the FHA-insured property may not be owned by a natural person, a Delaware Statutory Trust or as tenants a Tenancy in common ~~Common~~;
  8. Any combination of ownership forms can be used to establish a joint venture, for the purpose of jointly sharing the risks and the rewards by contributing the appropriate knowledge, skills, or assets that are necessary for a successful development project. However, a single-asset borrower entity is always required.

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**D. Foreign national and corporate entity participation.** Generally, foreign nationals and corporate entities may participate as either Active or Passive Principals. However, the single-asset borrower entity must be registered in the United States in the state where their corporate office is located and 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 the Principal to exercise operational decision-making authority. Each foreign national individual or foreign national controlled private entity that is an Active or Passive Principal must be listed on the Borrower’s organizational chart. Individuals who satisfy the Controlling Participant requirement for a presence in the United States may not be replaced without HUD approval.

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~~Where eligible to do so, foreign~~ Foreign participants must obtain an international tax identification number (“ITIN”) from the Internal Revenue Service. The U.S. domiciled, controlling participant will be a named party in paragraph 38 of the appropriate Regulatory Agreement. Information on the process to obtain an ITIN is available at: <http://www.irs.gov>~~http://www.irs.gov~~.

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**E. Identifying the principals:** ~~A principal is a public or private entity proposing to participate in a project as a Borrower, Operator, parent of the Operator, Management Agent, general contractor or the like. A principal can have an active role in a project and direct the activities~~

122 and affairs of the borrower entity or be involved in decision-making; or a principal can have  
123 a passive role where the principal's participation is limited to an ownership interest in the  
124 project. All principals must be identified and analyzed based on their experience,  
125 creditworthiness, and financial histories.

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127 **1. Principals:** "Principals" are:

- 128 a. The borrower entity, any entities and individuals with a significant ownership  
129 interest in the borrower entity (as described below), and any affiliate (whether  
130 individual or entity) of the borrower entity or any of the individual or entities with  
131 a significant ownership interest. For partnerships, all general partners are  
132 principals, and limited partners having a 25% or more interest in the partnership  
133 are principals. If the principal is a corporation, all operating officers, all officers  
134 of the board of directors, and each stockholder having a 10% or more interest in  
135 the corporation are principals, and all limited partners having a 25% or more  
136 interest in the corporation are principals. For non-profit corporations, principals  
137 include officers of the board of directors and any staff members who are  
138 designated by the corporation as corporate officers.
- 139 b. All managers and managing members of LLCs are principals and all members  
140 that have a 25% or more interest in the LLC are principals. A member is an  
141 owner of the LLC and is similar to a stockholder in a corporation. A manager is a  
142 person chosen by the members to manage the LLC and is similar to a director of a  
143 corporation. A manager can also be a member.
- 144 c. General contractors.
- 145 d. Management agents (*Note: the Lender does not have to conduct a financial*  
146 *and credit analysis of a management agent.*)
- 147 e. Packagers, and other persons or organizations hired to furnish advisory  
148 services in connection with project financing, construction or operation are  
149 principals even if the services provided are limited to selecting and  
150 negotiating contracts with contractors, architects, attorneys or managing  
151 agents; or to negotiating contracts to secure financing for the project; and
- 152 f. Consultants (except for architects and attorneys that are engaged in an arm's  
153 length cash fee arrangement to provide professional services for a project and  
154 who do not have an ownership interest or a management role, or who do not  
155 participate in other ways as a principal in the project).

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157 **2. Non-principals:** Those who are not considered "principals" for purposes of credit  
158 and financial investigations are:

- 159 a. Stockholders with less than 10% interest in a corporation;
- 160 b. Limited partners with less than 25% interest in the partnership;
- 161 c. Attorneys and architects with only an arms length fee arrangement to provide  
162 services for a project;
- 163 d. Minor corporate officers;
- 164 e. Subcontractors;

- ~~f. Brokers whose services are limited to referring the loan to a Lender and presenting information on behalf of the Borrower (provided that the services provided fall short of consultant or packaging services);~~
- ~~g. Public housing authorities;~~
- ~~h. Members of a non-profit's board of directors who are not board officers and do not have a decision-making role over the property;~~
- ~~i. Officers of passive investors (e.g., pass-through/shell companies, tax credit investors, or syndicators);~~
- ~~j. Management agents.~~

~~*Note: A determination of the principals of a trust requires an analysis of which individuals control the assets of the trust and what restrictions are placed upon them. Individuals who have effective control of trust assets should be treated as principals. The Lender Narrative should explain the Lender's identification of trust principals.*~~

Principals are defined by the Controlling Participant definitions as set forth in 24 C.F.R. §200, Subpart H; Housing Notice H 2016-15, and any successors thereto.

**F. Other Controlling Participants-Parent Companies:** A parent company is a company that has a controlling interest in another company, giving it control of its operations. Parent companies can be either hands-on or hands-off owners of their subsidiaries, depending on the amount of managerial control given to subsidiary managers, but are always considered to maintain a certain level of active control. Operator entities proposed for FHA-insured financing may be identified as having a parent entity when one or more of the following conditions exist: a) individual facility financials are consolidated into a larger financial statement and/or audit; b) there are individuals in common who have been previously identified as having a Controlling Participant role in other FHA-insured projects; c) there is group branding among projects; d) consolidated operations exist among multiple facilities; or e) the parent entity qualifies as a Controlling Participant under 24 C.F.R. §200, Subpart H and Housing Notice H 2016-15.

Regardless of whether or not 24 C.F.R. § 200, Subpart H, and Housing Notice H 2016-15 considers the Parent of the Operator to be a controlling participant for previous participation review purposes, the lender is required to complete a financial capacity, creditworthiness and character review of Parent of the Operator entities associated with Section 232 projects.

**F.G. Liability:** Section 38 of the Healthcare Regulatory Agreement – Borrower (Form HUD-92466-ORCF), Nonrecourse Debt, requires that individuals or entities who will be personally liable for certain enumerated matters be identified within the document. This is done by reference to the Section 38 Addendum, which is attached to the document.

1. For privately held entities: Section 38 generally requires two signatures ~~for~~from

- 207 project ~~sponsors~~principals. In most cases, HUD, upon the Lender's recommendation,  
208 shall select one individual signatory to sign in his or her individual capacity and the  
209 project parent/~~sponsor~~ entity to sign in a corporate capacity. In any specific deal,  
210 underwriting may point to a different entity with the requisite control and  
211 involvement or interest in the Project, positive credit history, and adequate financial  
212 strength relative to the size of the loan to serve in the capacity required by Section  
213 38.
- 214 2. For publicly traded corporations or REITS, or Non-profit organizations: The  
215 parent/sponsor entity itself is acceptable as the sole signatory. For such entities, any  
216 individual signing on behalf of the corporate entity does not sign in an individual  
217 capacity, but to bind the parent/sponsor, and no personal liability will be claimed  
218 against the individuals signing in such a capacity.
  - 219 3. For any corporate entities required to execute Section 38: Every corporate officer is  
220 not required to sign. Whomever the corporation entity has authorized to bind the  
221 company in connection with the proposed transaction may sign, provided that ORCF,  
222 upon considering the Participant Credit and Financial Review, has discretion to  
223 require additional signatories if warranted in a specific (exception) situation.
  - 224 4. If state or local law requires these signatures to be notarized in order for Section 38 to  
225 be enforceable or for recordation purposes, then the signatures are to be notarized.
  - 226 5. Please note the following prohibitions related to Section 38:
    - 227 a. Insertions of "or successors" language to the identification of signatories is  
228 NOT allowed. The Regulatory Agreement can and should be amended when  
229 there is a new individual who is responsible for the provisions of Section 38.
    - 230 b. Riders to the Regulatory Agreement that attempt to limit a signatory's liability  
231 are NOT allowed.
    - 232 c. Section 38 may not be omitted because a project has been processed as an  
233 (a)(7) versus another section of the Act.
  - 234 6. It is the Lender's responsibility to perform the Participant Credit and Financial  
235 Review of the parent/~~sponsor~~ entity and to identify and justify who has been proposed  
236 to sign Section 38 of the Regulatory Agreement.

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238 ~~G. **Controlling Participants for Previous Participation Review Purposes.** Controlling~~  
239 ~~Participants for Previous Participation review purposes may or may not be the same as the~~  
240 ~~principals for credit review purposes. See Housing Notice H 2016-15 (or successors thereto)~~  
241 ~~for additional details on who must file a previous participation certification.~~  
242

243 H. **The credit investigation.** Lenders are required to obtain and analyze credit reports or credit  
244 histories in order to validate and check the information contained in the financial statements and  
245 application forms that are submitted by the Borrowerprincipals. Credit reports give a picture of  
246 the Borrower's principal's payment history and financial interactions with its creditors, and  
247 allow the underwriter to make sound conclusions about the Borrower's credit-  
248 worthinessprincipal's creditworthiness. Credit reports also assist the Lender in reconciling  
249 any significant contradictions between the financial statements and the credit report.

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251 A commercial credit report for a business or a ~~residential mortgage~~ tri-merge or tri-merge  
252 plus type credit report for individuals must be current within 60 days of the application  
253 acceptance date and the Office of Residential Healthcare Facilities (“ORCF”) may require  
254 updated reports during processing. Credit investigation, including analysis of credit reports  
255 are, is required on:

- 256 1. The borrower and controlling participants.
- 257
- 258 2. The facility operator and controlling participants.
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- 260 3. The parent of the operator and controlling participants.
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- 262 4. The general contractor entity, if formed, before submission of an application.  
263 However, ORCF does not require credit reports or investigation of the individual  
264 Controlling Participants of the general contractor.
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- 266 5. ORCF does not require credit reports or credit investigation for the Management  
267 Agent or the individual Controlling Participants of the Management Agent.
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- 269 2. 10%, up to a maximum of 10, of the Principals of the Borrower as defined in Section  
270 6.1H above. (Note: If a principal is a business entity, i.e., corporation, partnership,  
271 limited partnership, with an operating history, a credit report is required only on the  
272 business firm, not the owners or partners of the firm.)
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- 274 6. All businesses principal’s other business ventures as selected by the Mortgagee.
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- 276 3. 7. Any principals with pending judgment(s), legal action(s), lawsuits, or bankruptcy  
277 claims.
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- 279 4. ~~10%, up to a maximum of 10, of the sponsor’s other business ventures as selected by~~  
280 ~~the Mortgagee.~~
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- 282 5. ~~1. The facility operator.~~
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- 284 6. ~~The parent of the operator.~~
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- 286 7. ~~The general contractor.~~
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- 288 8. ~~The housing consultant, as applicable, for non-profit transactions.~~
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291 ~~9. A credit review of members of public and non-profit boards of directors is not~~  
292 ~~required unless the board member is also a board officer with an operational decision-~~  
293 ~~making role over the property.~~

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295 **I. Lender's review of the credit report.**

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297 1. The Lender may obtain a Dun & Bradstreet or similar commercial credit report for  
298 business entities and a ~~residential credit report~~tri-merge or tri-merge plus type for  
299 individuals. An acceptable commercial credit report should include public filings  
300 (lawsuits, liens, judgments, bankruptcies and federal debt; Uniform Commercial Code  
301 (UCC) filings~~);~~ credit payment history; financial stress/payment trends compared to  
302 industry standards; and a credit payment delinquency risk score over a twelve-month  
303 period.  
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- 305 2. The Lender should compare all information obtained from credit reports and credit  
306 histories to the financial statements provided by the relevant Borrower, Operator or  
307 principal(s). Any contradictory information should lead to further inquiry until the  
308 evidence shows a consistent and complete picture.  
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- 310 3. The Lender should make reasonable inquiries to determine if the applicant or any  
311 principal is in default on any federal debt (i.e., direct loans, FHA-insured loans,  
312 student loans, and Small Business Administration loans) or any judgment liens  
313 against the property for a debt owed to the federal government.  
314
- 315 4. The Lender should determine if the information is incomplete, or if there are  
316 inconsistencies or discrepancies between the information included in the financial  
317 statements and the information in the credit reports and resolve those inconsistencies  
318 or discrepancies.  
319
- 320 5. The Lender should investigate any adverse credit information that appears on the  
321 credit report or adverse character information that becomes known from making  
322 inquiries of bank and trade references and of other HUD offices. The Lender must  
323 require a written explanation of any late payments, adverse actions, judgments, or  
324 other derogatory information found in their investigation.  
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327 6. lender should affirmatively conclude, in writing, in the Lender's Narrative, that a  
328 principal's current credit investigation findings and financial history are acceptable  
329 for participation in HUD programs.  
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- 331 **J. Delinquent federal debt:** When a delinquent federal debt exists, the Lender shall include as  
332 part of the required application exhibits:  
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- 334 1. a detailed written explanation from any applicant or principal with a prior federal  
335 default or claim or whose credit report and financial statements contain conflicting or  
336 adverse information.  
337
- 338 2. a letter from the affected agency, on agency letterhead, signed by the appropriate  
339 agency officer, stating that the delinquent federal debt is current or that satisfactory  
340 arrangements for repayment have been made.  
341
- 342 3. the Lender's reason(s) for recommending the applicant, which may be included in the  
343 Lender Narrative.  
344

345 **K. Additional review:** In addition to the formal documents and credit investigation described  
346 above, the Lender's underwriter must conduct and describe the results of a thorough internet  
347 search of each principal and determine if there are any citations or character issues which  
348 raise concerns about their creditworthiness of any principal or reputational risk to the  
349 Department.  
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351 The lender must provide evidence that principals in a transaction are of strong  
352 character. Principals with prior convictions of fraud, or other types of activities indicative of  
353 poor character or reputational risk to the Department, particularly but not exclusively related  
354 to healthcare facilities, may not be eligible for the Section 232 program. This review is in  
355 addition to the Previous Participation requirements in 24 C.F.R. § 200, Subpart H and  
356 Housing Notice 16-15.  
357

358 **L. Rejection because of unacceptable credit.** ~~The~~ or other perceived risk. Lenders should  
359 use ~~its~~ professional judgment when approving or rejecting a principal based on the applicable  
360 principal's creditworthiness ~~and character.~~ The individual may be rejected if:  
361

- 362 1. the credit investigation evidences that the principal has a history of not paying  
363 creditors in a timely manner ~~or~~ lacks liquidity or is of questionable character.  
364
- 365 2. any delinquent federal debt has not been resolved or satisfactory arrangements for  
366 repayment have not been made.  
367
- 368 3. There are judgments or actions against the principal that:  
369 a. could significantly impact ~~upon~~ the financial position of the individual/ firm  
370 or corporation.  
371 b. result in a determination that the individual, firm or corporation is an  
372 unacceptable credit risk.
- 373 4. ~~the~~The principal is insolvent or is the subject of a pending bankruptcy or insolvency  
374 proceeding at the time of application, firm commitment, or at the time of loan closing.  
375 [Note: The Lender should update credit reports or investigations at firm commitment  
376 and prior to closing].]

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If any of these or other adverse conditions exist but the Lender nevertheless determines the principal to be an acceptable risk, documentation on the mitigating circumstances must accompany the application. The Lender’s assessment of the principal’s credit and character will be reviewed by the ORCF Underwriter during the underwriting process. Additional information or clarification may be required from the principal to satisfy HUD that the principal is an acceptable credit/character risk. The final determination of acceptable credit/character lies with the ORCF Underwriter and the Loan Committee.

5. There are financial or other characteristics which increase financial or reputational risk to the FHA insurance fund. The decision of rejection may be extended to participants who are not identified as Controlling Participants, but who may still present unacceptable financial or reputational risk to the Department as non-controlling, passive, or another type of investor in the project. In that regard, during underwriting, Lenders must identify additional persons or entities who, though not Controlling Participants, can play a significant role in, or whose presence can have a significant impact on, the transaction. If the Lender has information suggesting that such party’s presence in the transaction may pose an unacceptable financial or reputational risk, then the Lender must disclose that information and explain how the risk is adequately mitigated.

6. If a principal is found unacceptable or ineligible for participation in a project, regardless of whether or not the principal has other ongoing involvement in other FHA-insured transactions, a familial relation, regardless of financial capacity or their experience, may not be inserted into the position of the principal who is determined to be unacceptable.

**M. Analyzing the Borrower, Operator, ~~parent of the Operator~~Controlling Participants and general contractor’s previous experience:** The Lender’s underwriter must evaluate the resume of each principal. Each principal must have good character, proven experience and qualifications in developing, leasing up, owning, or building health care facilities similar in size and acuity level to the proposed project. The Lender should pay particular attention to:

1. the type and size of previous residential healthcare facilities in which the applicable principal has been involved and assess whether the principal’s requisite business experience shows that the principal is able to operate and manage a residential healthcare facility of the size and complexity of the subject property throughout the term of the mortgage. For Borrowers on a property receiving LIHTC or other forms of public subsidy, the Lender must ensure that the Borrower has demonstrated experience in owning comparable regulated and subsidized properties and assess the Borrower’s handling of any adverse circumstances.

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420 2. the geographic area, market, and particular regulatory environment of business  
421 involvement.  
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423 3. the length of time of the principal's involvement with development, lease-up,  
424 ownership and operation of residential healthcare facilities.  
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426 4. past roles performed by each principal in the residential healthcare business.  
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428 5. For new construction, the past history of the proposed development team (borrower,  
429 operator, management agent, as applicable) in working together to successfully  
430 develop healthcare facilities of a similar bed size and acuity level should be  
431 demonstrated.  
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433 Each resume should demonstrate the level of experience and sound character needed to  
434 successfully complete the development of the proposed project. The Lender should  
435 identify new Borrowers whose primary business is not healthcare facility development or  
436 operations, that have little residential healthcare experience, or that are new to a  
437 particular market or state regulatory environment. It may be necessary to inspect a  
438 sample of the new Borrower's real estate holdings to determine the quality of the assets  
439 and management of the Borrower's existing portfolio. The Lender should explain any  
440 identified risks in the Borrower's existing portfolios. The Lender may require that the  
441 Borrower bring in additional members to the development team to satisfy the experience  
442 requirements.  
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- 444 N. Fair Housing Act violations: Any principal found to have an outstanding violation of the  
445 Fair Housing Act by the final determination of an administrative agency or court is ineligible  
446 under this section to participate in the Section 232 Program, unless the principal is operating  
447 under a remedial order or agreement.  
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## 6.2

## Participant Financial Review

- 450  
451 A. Financial statements give a picture of the financial position of an individual or a company at  
452 a certain point in time and provide historical information for measuring and evaluating the  
453 financial performance of a principal or a firm, and advance warning of financial problems.  
454 Lenders should use the information in financial statements to determine if the Borrower,  
455 Operator, ~~parent of the Operator~~ Controlling Participants and/or their principals have the  
456 financial capacity to develop, build and complete and operate the project, and whether the  
457 general contractor has the ability to deliver the project based on their respective:  
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- 459 1. past financial condition;

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- 2. present liquidity;
- 3. projected future financial capacity.

The Lender must complete a financial review to determine the amount of funds available for investment in the project by performing an analysis of the working capital for a proposed project. Working capital is the difference between current assets and current liabilities and may be used to purchase assets, pay off debt and make up deficits from operations. The financial analysis also determines which non-pledged, unsecured assets can be readily hypothecated to secure the proposed FHA-insured loan.

- B. ~~B.—Exhibits:~~ The Borrower, Operator, ~~parent of the Operator, Controlling Participants~~ and general contractor must furnish current financial statements with supporting schedules as part of the application for commitment processing.

*Note: For new construction and substantial rehabilitation projects the firm commitment application must include the last three (3) full years and year-to-date financial statements for the party who will be responsible for providing the financial requirements for closing and beyond. The Lender Narrative must also include a discussion on the available working capital of this party and the party’s ability to support the project over the long term. In cases where a group of individuals come together on one project to meet the cash requirement, a **Form HUD-92417-ORCF**, Personal Financial and Credit Statement, covering one full year for each member of the group will be satisfactory.*

- 1. Individuals must submit either:
  - a. a complete Personal Financial and Credit Statement (Form HUD-92417):
    - i. the spouse of married sponsors or principals must also sign the form.
    - ii. if a spouse’s signature cannot be obtained, the principal must prepare the form reflecting only those assets that are solely in the principal’s name and any liability, including those joint liabilities, for which the principal is responsible; or
  - b. a substitute statement that contains, at a minimum, the information contained on the Personal Financial and Credit Statement. The statement must contain the following certifications and criminal warning:

*I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the Borrower [owner] for the purpose of obtaining mortgage insurance under the National Housing Act are true and give a correct showing of \_\_\_\_\_’s (Name of Borrower or owner) financial position as of \_\_\_\_\_ (date of financial statement).*

Signed this \_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_. Signature of authorized agent with name printed or typed under signature \_\_\_\_\_.

~~Warning – HUD will prosecute anyone who knowingly submits a false claims and statements. Conviction may result in 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).~~

For married individuals, the spouse also must sign the certification.

2. Business entities must submit separate statements and supporting documents, set forth below, for the last three (3) years or the length of their existence. If the entity has been in existence less than three (3)-3 years, an authorized officer of the organization must provide the statements and supporting documents with a signed statement that there has been no material adverse change since the date of the statements.
  - a. Balance Sheet that:
    - i. provides a breakdown of current and non-current assets;
    - ii. identifies restricted and non-restricted funds;
    - iii. provides a breakdown of current and non-current liabilities;
    - iv. identifies the current portion of long-term debt; contingent liabilities, including debts under secured or unsecured lines of credit or letters of credit, personal guaranties, obligations to limited partnerships and other obligations payable in the future, including the amount and duration of the obligation; and
    - v. lists details of any factors that may materially affect the Borrower's or sponsor's financial position now or during the term of the proposed FHA-insured mortgage.
  - b. Income and expense statement that reflects:
    - i. income from normal operations;
    - ii. investment income;
    - iii. other income; and
    - iv. total expenses.
  - c. If the financial statements are audited, a statement of changes in financial position; or if a fund accounting system is used, a statement of changes in fund balances, and all notes.
  - d. Supporting Schedules:
    - i. an aging schedule of accounts receivable that provides the name, type of account (trade, affiliate, employee, relative or other), payment terms, amount, and aging information.
    - ii. an aging schedule of notes receivable that provides the name, type of account, payment terms, maturity date, current portion (due within one (1) year or one operating cycle of the business, whichever is less), past due amounts and non-current amounts.

- 545                   iii.    schedule of pledged assets, if applicable, identifying each pledged  
546                   asset, the amount pledged and the offsetting liability.
- 547                   iv.    schedule of marketable securities that provides: name, number of  
548                   shares, current market values as of the date of the statement, and the  
549                   exchange where the shares are listed.
- 550                   v.    schedule of accounts payable that provides: name, type of account (trade,  
551                   affiliate, employee, relative or other), payment terms, amount and aging  
552                   information.
- 553                   vi.    schedule of notes and mortgages payable that provides: name, type of  
554                   account, payment terms, maturity date, current portion (due within one  
555                   (1) year or one operating cycle of the business, whichever is less), past  
556                   due amounts and non-current amount.
- 557                   vii.   schedule of legal proceedings, if applicable.
- 558                   viii.   in addition to the applicable schedules set forth in subparagraphs 1-7  
559                   above, general contractors must submit a schedule of jobs (work) in  
560                   progress that identifies, for each job, the:
- 561                           a.   original contract price;  
562                           b.   construction start date;  
563                           c.   construction completion date; and  
564                           d.   percentage of completion.  
565                           e.   combined or consolidated financial statement(s), if applicable.
- 566                   e.   Other financial data necessary to determine the financial responsibility and  
567                   capacity of the Borrower, parent of the Borrower, Operator, parent of the  
568                   Operator and their respective principals, and the general contractor,
- 569                   f.   The certification must be signed and dated by an authorized official of the  
570                   company. The certifications must reference the name of the business and the  
571                   date of the financial statement(s).
- 572
- 573   3.   **Section 223(f) project financial statements:** The proposed Borrower, Operator, and  
574   Controlling Participants must submit financial statements for the last three (3) fiscal  
575   yearyears of the project and if more than three (3) months have expired since the  
576   closing date of the financial statements, a year-to-date balance sheet and operating  
577   statement. If financial statements are not available due to circumstances beyond the  
578   Borrower's Controlling Participant's control, the Borrower Controlling Participant  
579   must submit:
- 580                   a.   evidence satisfactory to the Lender that the financial statements are not  
581                   obtainable;
- 582                   b.   project financial statements that are available including an owner-certified  
583                   balance sheet and operating statement and
- 584                   c.   in all cases, the past three (3) years of tax returns for the property and the  
585                   borrower entity.
- 586

- 587 4. The BorrowerControlling Participant must certify any financial statement or balance  
588 sheet and operating statement, each of which must include the criminal warning set  
589 forth in Section 6.2.B.1.b(3) above.  
590

591 C. If the financial statements are not available, the Lender's case file must contain a statement  
592 from the BorrowerControlling Participant that explains why all the required records are not  
593 obtainable and a memorandum from the Lender to the ORCF stating that the Lender has  
594 evaluated the Borrower'sControlling Participant's statement and agrees that the information  
595 is not available. **Processing financial statements and other documents:** A financial  
596 statement is considered current if it is no more than three (3) months old when the application  
597 is submitted by the Lender for firm commitment review. ~~The Lender must determine~~  
598 ~~financial stability and financial strength, unless the Borrower and sponsor is a public~~  
599 ~~company with an investment grade credit rating.~~ The Lender's review should take the  
600 following factors into account:

- 601
- 602 1. The credit investigation or other circumstances may warrant more current financial  
603 statements; therefore, the Lender should:
    - 604 a. assess the adequacy of each participant'sControlling Participant's liquidity  
605 and ability to provide immediate and ongoing support to the project, as well as  
606 to any asset that is in financial difficulty.
    - 607 b. review other sources of sponsorthe Controlling Participant's cash flow in the  
608 analysis, if the source and stability of the cash flow has been verified by  
609 reviewing historical ~~tax returns, financial statements.~~ Interest income from  
610 notes receivable, real estate investment income, dividend income, and  
611 sponsorthe Controlling Participant's salaries should not be included.
    - 612 c. review audited or reviewed financial statements prepared by a CPA or IPA  
613 that are up to one (1) year old. Audited or reviewed statements must be  
614 supplemented with updated interim financial statements and supporting  
615 documentation, which may be management-prepared, if more than six (6)  
616 months have lapsed since the closing date of the audited statement.
  - 617
  - 618 2. The Lender should review the financial statements of the participantsControlling  
619 Participants and the general contractor to determine the amount of working capital  
620 available for the project. The net working capital should be adjusted to reflect  
621 contingent liabilities and the financial needs of other projects undertaken by the  
622 participantsControlling Participants and the general contractor that are in the planning  
623 stage or under construction, as applicable.  
624
  - 625 3. The Lender ~~should~~may recommend that a loan be approved based on the "true net  
626 worth" of a participantControlling Participant rather than on working capital.  
627 Existing assets, not working capital should be used to secure the FHA-insured  
628 mortgage loan. The Lender should review existing assets, loans, and lines of credit.  
629 The Lender should require the participantControlling Participant to provide a

630 commitment letter from ~~the~~ lending institution for the outside line of credit or loan  
631 that states:

- 632 a. the rate, amount, term, and conditions, if any, of the loan that the lending  
633 institution is willing to provide.
- 634 b. the date by which the commitment letter must be exercised; the date must  
635 extend at least to the anticipated date for initial endorsement.
- 636 c. the party that will be responsible for repayment of the loan or line of credit, if  
637 the commitment is exercised. Note that: repayment may not be an obligation  
638 of the ~~borrower~~proposed HUD Borrower entity.

639 The letter must include a certification indicating that the lending institution will not  
640 make any claim against the mortgaged property, mortgage proceeds, any reserve or  
641 deposit required by ORCF, or against the rents or other income from the mortgaged  
642 property for payment of the loan or line of credit. This certification must contain the  
643 criminal certification set forth in Section 6.2.B.1.b (3) above.

- 644
- 645 4. Funds provided by a parent company or affiliate of the ~~participant~~Controlling  
646 Participant require a certification from the board of directors or an authorized agent  
647 that specifies the amount of funds that the parent company or affiliate will commit to  
648 the project. The Lender should determine the availability of funds from the parent  
649 company or affiliate and consider whether:
  - 650 a. individual corporations have any excess operating capital.
  - 651 b. the laws under which the entity is incorporated, or its exiting lenders permit:
    - 652 i. withdrawals, loans or advances to owners or sponsors;
    - 653 ii. stock investment in affiliated corporations; and
    - 654 iii. guarantee of debts of associated corporations.
- 655
- 656 5. Letters of intent and letters of credit cannot be used to establish financial capability.  
657 At initial endorsement, however, letters of credit may be substituted for cash to set up  
658 many of the escrows required at initial and final endorsement, or during construction.  
659 If a participant draws down cash at initial closing to satisfy escrow requirements, a  
660 letter of credit cannot be substituted to establish the same escrow requirements.
- 661
- 662 6. Individuals are prohibited from submitting financial statements as a  
663 ~~participant~~Controlling Participant and then abandoning the project and the Borrower  
664 after the firm commitment is issued. The Lender should require a certified statement  
665 from the ~~participant~~Controlling Participant stating the participant's commitment to  
666 the project and specifying the amount of funds that will be reserved for contingent  
667 needs through final closing and sustaining occupancy.
- 668
- 669 7. The submission of a financial statement that is used to influence Federal Officials  
670 concerning a mortgage insurance risk determination when the ~~participant~~Controlling  
671 Participant does not plan a continuing relationship with the Borrower could result in

672 appropriate sanctions being taken against the sponsor including suspension or  
673 debarment.

674  
675 8. General Contractor with adequate capital: The general contractor's adjusted working  
676 capital position should equal five percent (5%) or more of the estimated construction  
677 contract for the project.

678  
679 If the general contractor does not have an acceptable working capital position, the  
680 general contractor's fixed assets may be hypothecated. The general contractor's  
681 ability to obtain a performance and payment bond does not negate or lessen this  
682 requirement.

- 683 a. The Lender should review the working capital that the general contractor has  
684 available for other projects in construction.
- 685 b. If the general contractor does not have an acceptable working capital position  
686 or sufficient fixed assets that can be hypothecated, a joint venture may be  
687 established with a general contracting firm that is financially stronger,  
688 provided that, the combined working capital of the firms equals at least 5% of  
689 all construction contracts that the firms have in construction and development.  
690  
691

### 6.3

## Evaluating Non-profit Borrowers and Participants

692  
693 A. **General:** Non-profit Borrowers (whether national, regional, or local) must have the  
694 experience and financial strength appropriate for the development and ownership of the  
695 proposed property. This section of the Handbook sets forth the criteria for making an  
696 evaluation of the experience and strength of non-profit Borrowers. The non-profit Borrower  
697 being evaluated may not have equal strength in all categories. In transactions where the  
698 ownership structure involves multiple entities performing different functions, the Lender  
699 should evaluate the non-profit Borrower and each of the other entities and their capacity to  
700 perform a particular function (e.g., ownership, ~~property management operations~~, acquisition,  
701 development, resident services or asset management). Entity ~~participants~~principals should  
702 have a prior acceptable history of successful development, ownership and management of  
703 assets that are similar in ~~bed/unit~~ size, and ~~healthcare acuity~~ complexity as the proposed  
704 project. Therefore, only the criteria for the areas for which the non-profit entity has direct  
705 responsibility or authority should be reviewed during the evaluation process. The Lender  
706 must include in the application:

- 707
- 708 1. the Developer's Agreement or any other document which shows the relationship and  
709 responsibilities of all parties associated with the transaction.
  - 710 2. the housing consultant's contract, if applicable.  
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3. a memorandum of findings and recommendations which includes:
  - a. a description of the relationship between the non-profit and any profit-motivated entities involved in the transaction;
  - b. the determination of eligibility or ineligibility of the non-profit Borrower/sponsor must be approved by the ORCF Underwriter.
4. Lender's determination of experience, character, and financial capacity of the non-profit Borrower and/or participantsprincipals should include, but is not limited to, the following documentation:
  - a. a detailed explanation of the motivation for sponsoring the project including a history of the organization's involvement in multifamily housinghealthcare;
  - b. a copy of the Borrower's charter and bylaws and all amendments;
  - c. a copy of any ruling denying tax exemption;
  - d. a verification from the Internal Revenue Service of the Borrower's tax-exempt status as a 501(c)(3) organization. If a ruling is pending, an explanation of the application's legal status;
  - e. a list of corporate officers or officersmembers of the board of directors of the sponsoring non-profit with decision-making authority (the principals) over the subject property, including their titles or positions, addresses, and individual social security numbers;
    - i. resumes for all principals and staff who will actively take part in the development of the proposed project.
    - ~~ii.~~ ~~current financial statement (balance sheet, profit and loss statement, and supporting schedules) as well as financial statements for the past three (3) years. If available, audited statements should be submitted. Financial statements should conform with the following:~~
      - ~~iii.ii.~~ ~~if the Borrower has existed less than three (3) years, the financial statements must be submitted from the date the group was formed.~~
      - ~~iv.iii.~~ Statements must identify restricted and unrestricted assets (liquidity) along with the related liabilities and must show no material, unmitigated contingent liabilities.
      - ~~v.iv.~~ an officer of the sponsoring non-profit must sign the financial statements.
      - ~~vi.v.~~ all statements must contain the certification of truth and accuracy and criminal certification identified in Section 6.2.B.1.b above. This certification must reference the name of the sponsor and the date of the financial statements.
      - ~~vii.vi.~~ a signed written resolution of the non-profit's directors or trustees, acknowledging the responsibilities and obligations of sponsorship and continuing ownership, and that the subject proposal reflects the will of the membership.
      - ~~viii.vii.~~ information contained in Section 6.1.Kthe Consolidated Certification if the participant or any officer has a prior federal default or claim.

- 755 f. a detailed statement of the arrangements made or proposed for the following  
 756 (listing principals involved, their relationship to the non-profit Borrower or  
 757 other participant, the terms of the arrangements and the circumstances  
 758 surrounding each):
- 759 i. land on which the project will be built.
  - 760 ii. project construction, including selection of general contractor,  
 761 subcontractors, and architect.
  - 762 iii. legal and consulting services.
  - 763 iv. project financing, including any discounts.
- 764
- 765 5. The non-profit sponsor must have diverse and stable funding sources with recurring  
 766 revenue and, if required, a proven record of raising sufficient funds to meet its  
 767 operating needs. The Lender must identify whether the non-profit ~~sponsor~~  
 768 ~~'s sponsor's~~ primary funding sources are from fees on development projects or from  
 769 sources such as public funding, public contracts, grants or donations that may be  
 770 subject to budget or funding constraints.
- 771 a. ORCF underwriter review stage: ORCF will review whether the non-profit  
 772 Borrower is qualified to start, complete and operate a project under the  
 773 insured loan programs and determine that all of the following criteria are  
 774 satisfied:
    - 775 i. the non-profit Borrower is acting on its own behalf and is not, either  
 776 knowingly or unwittingly, under the influence, control, or direction of  
 777 any outside party seeking to derive a profit or gain from the proposed  
 778 project (such as a landowner, real estate broker, contractor, architect,  
 779 attorney, or consultant);
    - 780 ii. the non-profit Borrower has continuity and a serious long-term  
 781 commitment to supply housing for the intended resident population;
    - 782 ~~iii. the non-profit Borrower has continuity;~~
    - 783 ~~iv.iii.~~ the non-profit Borrower has strong roots in the neighborhood and local  
 784 community and a good reputation for reliability, service, and  
 785 commitment to the people for whom the housing is to be built;
    - 786 ~~v.iv.~~ the board of directors demonstrates ties to the local community served  
 787 by the non-profit and includes representatives on the board from the  
 788 local business community; and
      - 789 a. the non-profit Borrower must fully understand the  
 790 responsibilities and obligations of
      - 791 b. developing a ~~housing~~residential healthcare project and  
 792 continuing its successful operation. This should be evidenced  
 793 by:
        - 794 i. general knowledge of the factors that contribute to a  
 795 project's success or failure;
        - 796 ii. familiarity with applicable healthcare facilities; and



840 payables that cancel each other and must not consider restricted-use funds in  
841 the analysis. The Lender should review the public records section of the  
842 credit report to eliminate assets that were used as collateral for secured  
843 borrowings.

844  
845 5. Carefully review the ability of the sponsoring organization to undertake a project of  
846 the size and complexity of the proposed project.

847  
848 ~~6. Review the developer's fee. Non-profits may earn a developer's fee on a new~~  
849 ~~construction or substantial rehabilitation proposal.~~

850  
851 *Note: The HUD Underwriter may check with applicable ORCF Account Executives*  
852 *or Multifamily Asset Management offices in the jurisdiction that the non-profit has*  
853 *done or now does business in order to ascertain the past experience and performance*  
854 *of the non-profit.*

855  
856 **C. Non-profit sponsor and a profit-motivated borrower entity:** A non-profit sponsor may  
857 establish a profit-motivated borrower entity for the purpose of owning a tax credit project or  
858 obtaining distributions from surplus cash. The formation of the profit-motivated entity may  
859 be approved provided that:

860  
861 1. the HUD closing attorney determines that there is no legal impediment that would  
862 prohibit approval of the request;

863  
864 2. the non-profit sponsor agrees to comply with the terms and conditions of the ~~non-~~  
865 ~~profit~~ regulatory agreement applicable to a profit-motivated entity;

866  
867  
868 3. the non-profit sponsor is subject to the mortgage limitations applicable to a profit-  
869 motivated entity;

870  
871 4. a working capital deposit is required (not applicable to Section 232 refinance  
872 projects);

873  
874 ~~5. a non-profit developer's fee is not paid with the proceeds of the FHA insured~~  
875 ~~mortgage loan;~~

876  
877 ~~6-5.~~ if the non-profit sponsor provides evidence that it has obtained exemption from  
878 real estate taxes, the tax exemption must run with the real estate and not with the type  
879 of sponsorship;

880  
881 ~~7-6.~~ the potential tax consequences, as well as the possible effect on the non-profit's  
882 Section 501(c)(3) status with the IRS is determined to be acceptable;

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886

8.7. ~~the~~ the profit-motivated borrower entity may not make distributions to any individual member or shareholder except as may be authorized by HUD in its sole discretion for purposes related to the mission of the sponsoring organization.

DRAFT