

### CHAPTER 3. FINANCIAL STATEMENTS

3-1.\*INTRODUCTION. The sponsor, mortgagor (if formed), principals of the mortgagor (refer to paragraph 2-1.B.2.g.(3)) and general contractor must furnish current financial statements with supporting schedules as part of the application for commitment processing. Exceptions to this requirement are:

A.Officers of a profit-motivated corporation do not submit financial statements unless they are:

1.A stockholder with a 10 percent or more interest in the mortgagor or

2.Providing funds to meet HUD's estimated cash requirement.

B.Officers of a nonprofit corporation do not submit financial statements unless they are providing funds to meet HUD's estimated cash requirement.

#### 3-2. FINANCIAL STATEMENTS.

A.Individuals must submit either:

1.Personal Financial and Credit Report, Form HUD-92417.

a.For married sponsors or principals, the Form also must be signed by the spouse.

b.If a spouse's signature cannot be obtained, the principal must prepare the form reflecting only those assets that are solely in their name and any liability, including those joint liabilities, for which they have any responsibility.

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2.A substitute statement, which contains at a minimum the information contained on Form HUD-92417,

a.Must contain the following certification and criminal warning (substitute appropriate language for Section 202/811 projects):

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(3-2) I HEREBY CERTIFY that the foregoing figures and statements contained herein submitted by me as agent of the mortgagor (owner) for the purpose of obtaining mortgage insurance under the National Housing Act [a Section 202 capital advance (substitute direct loan, if applicable) under Section 202 of the Housing Act of 1959, as amended,] [a Section 811 capital advance under Section 811 of the National Affordable Housing Act of 1990, as amended,] are true and give a correct showing of \_\_\_\_\_'s (Name of mortgagor or owner) financial position as of \_\_\_\_\_ (date of financial statement).  
Signed this \_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_

\_\_\_\_\_  
(Signature of authorized agent with name printed or typed under signature)

\*Warning -- HUD will prosecute false claims and statements. Conviction may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802) \*

b. For married individuals, certification also must be signed by the spouse. Refer to paragraph 1.b. above.

B. Business entities must submit the following separate statements and supporting documents for the last 3 years or the length of existence, if less than 3 years, signed and dated by an authorized officer of the organization.

1. Balance Sheet that:

a. provides a breakdown of current and noncurrent assets and liabilities;

b. identifies restricted and nonrestricted funds; and

c. identifies the current portion of long-term debt.

2. Income and Expense Statement that reflects:

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(3-2) a. income from normal operations;  
b. investment income;  
c. other income; and  
d. total expenses.

3.Statement of Changes in Financial Position or, if a fund accounting system is used, a Statement of Changes in Fund Balance.

4.Supporting schedules:

a.An Aging Schedule of Accounts Receivable that provides:  
name, type of account (trade, affiliate, employee, relative or other), payment terms, amount and aging information.

b.An Aging Schedule of Notes Receivable that provides:  
name, type of account, payment terms, maturity date, current portion (due within 1 year or one operating cycle of the business, whichever is less), past due amounts and noncurrent amount.

c.Schedule of Pledged Assets, if applicable. Identify the pledged asset, the amount pledged and the offsetting liability.

d.Schedule of Marketable Securities that provides:  
name,  
number of shares, current market value as of the date of the statement, and exchange where listed.

e.Schedule of Accounts Payable that gives information outlined in paragraph a above.

f.Schedule of Notes and Mortgages Payable that gives information outlined in paragraph b above.

g.Schedule of Legal Proceedings, if applicable.

\* h. In addition to the applicable schedules in paragraphs a through g, general contracting firms must submit a schedule of jobs (work) in progress that identifies:

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(1) original contract price;

(2)construction start date;

(3)construction completion date; and

(4) percentage of completion.

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5.Combined or consolidated statement(s), if applicable,

6.Other financial data necessary to determine the financial responsibility and capacity of the sponsorship or general contractor,

\* 7. Interim financial statements with supporting schedules if more than 3 months (6 months, if latest year's statements were audited) have lapsed since the date of the latest year's financial statements, and

8.The certification, signed and dated by an authorized official of the company, of truth and accuracy and the criminal warning reflected in  
paragraph 3-2.A.2.\*

3-3.A CURRENT FINANCIAL STATEMENT is not more than 3 months old when Form HUD-92013 is accepted for processing. Exceptions:

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

\* B. Audited financial statements prepared by an independent Certified Public Accountant or a Public Accountant may be up to a year old. The audited statements must be supplemented with updated interim financial statements, which may be management prepared, if more than 6 months have lapsed since the closing date of the audited statement.  
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3-4.MORTGAGOR ENTITY WITH ADEQUATE CAPITAL. Do not require financial statements of the individual ownership interest(s).

3-5.OBJECTIVE OF FINANCIAL STATEMENT ANALYSIS. Financial statements provide historical information for measuring and evaluating financial performance and provide advance warning of financial problems.

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(3-5) A. Use this information to determine if the sponsors, the mortgagor or the principals of the mortgagor have the financial capacity to develop, build and complete the project and whether the general contractor can deliver the project based on:

- 1.past financial condition;
- 2.present liquidity; and
- 3.projecting future financial capacity.

B.Complete financial analysis with the objective of determining the amounts available for investment in the

project by performing an analysis of working capital and determining which nonpledged, unsecured assets can be readily hypothecated to produce the required investment.

### 3-6. HOW TO ANALYZE FINANCIAL STATEMENTS

A. Current Assets are cash and other assets convertible into cash during the normal operating cycle of business operations or 1 year, whichever is less.

1. When reviewing cash, consider compensating balances that would limit the amount of available cash.

2. Determine the current value of readily marketable stocks and bonds.

3. Evaluate the accounts receivable and classify the following as noncurrent.

a. Amounts due from officers and employees.

b. Amounts advanced to subsidiary, affiliated or associated companies.

c. Disputed accounts receivable.

d. Accounts receivable past due for more than 60 days. Funds from a local, State or Federal source past due beyond this period may be considered if evidence is provided that source is historically late and it can be expected that these funds will be received before initial closing.

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(3-6) 4. Using a Schedule of Accounts Receivable by Age, determine if the amount allowed for doubtful accounts, if any, is adequate.

5. Recognize only syndication proceeds from other projects and notes receivable to be collected during the normal operating cycle or 1 year, whichever is less.

6. If the statement is audited, evaluate inventory and establish its liquidation value, relying on the accountant's review. Do not consider inventory, if statement is unaudited.

7. Recognize only prepaid expenses for the project.

8. Do not include:

a.Equity in the proposed site, since consideration is given on Form HUD-92264-A, Part A.

b.Cash equity in land or properties unless they are readily marketable and intended for the sale market.

c.Anticipated profits from business ventures.

d.Equities in real estate encumbered by high ratios of loan to value mortgages, unlisted stocks, goodwill, and other intangible assets.

B.Current liabilities are payables due during the normal operating period or 1 year, whichever is less.

1.Include as current liabilities, regardless of term, those liabilities relating to marketable land and completed properties that were treated as current assets.

2.Consider amounts due to officers, employees, affiliates or stockholders as current liabilities unless the obligations have a definite long-term maturity.

3.Consider amounts needed to satisfy broker's margin account (brokerage account allowing customers to buy securities with money borrowed from the broker).

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(3-6) 4. Consider current principal portion of long-term liabilities.

5.Current year income tax payable. Normally, deferred income taxes are not considered current as long as the economic outlook of company does not appear to be in an adverse trend.

6.Do not include the amount outstanding on the project land, since this obligation is considered on Form HUD-92264-A, Part B.

C.Working capital is the excess of current assets over current liabilities. If current liabilities exceed current assets, precede the difference with a minus sign to show a deficit.

D.Adjust the net working capital to consider:

1.Effects of contingent liabilities.

2.Financial needs of other projects in the planning stage or under construction.

E.Contingent Liability Related to Agreement for Payment of Real Property Taxes by Sponsor, Form FHA-1708. This agreement requires the sponsor to make a lump sum payment to cut the mortgage to an amount that could be carried by the mortgagor on a tax-paying basis if a project does not obtain or loses its abatement or exemption from real estate taxes in the future.

1.Do not require this Form if tax exemption is granted based upon State legislation granting tax exemption to particular types of housing, e.g., housing located in urban renewal areas or housing for low and moderate income groups or for other social needs.

2.Do require this Form for all insured projects if tax exemption is granted based upon general charitable statutes.

3.Treat this as a contingent liability when analyzing the Sponsor's financial statements.

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(3-6) 4. If the Sponsor does not evidence the capacity to meet the financial requirements for closing plus this contingent liability, process on a tax-paying basis.

5.This requirement is not applicable to Section 202 or 811 projects in which the Field Counsel has concurred in the validity of the exemption based upon special legislation or general charitable statutes.

F.If funds are being provided by a parent company or affiliate of the sponsor:

1.Require a certification from the Board of Directors or authorized agent that specifies the funds the parent company/affiliate is willing to commit.

2.Establish the availability of funds from parent company/affiliate. Consider whether:

a.Individual corporations have any operating capital to spare.

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.

c.In analyzing financial statement:

(1)Do not consider interlocking debts, receivables and investments between all affiliated corporations.

(2)Consider only those assets readily available for investment by the mortgagor.

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(3-6) (3) Do not consider the operating capital or net worth of rental project holding corporations as assets available for closing.

3.Require the parent company/affiliate to submit the same certification identified in paragraph 3-8.B.3.b.

3-7.\* FINANCING PLAN. If the mortgagor or its principals do not evidence the sufficient working capital to meet the cash requirements estimated on Form HUD-92264-A, contact the mortgagee to advise that the mortgagor must submit a financing plan detailing how the cash requirements will be met within ten working days.

A.The financing plan must indicate:

1.All sources from which capital is obtained;

2.Verification from the source(s).

3.Financial statements from the organization or individual(s) supplying the capital.

4.Those fixed assets, if any, that will be used to secure a loan. Refer to paragraph 3-8.

5.Details on the repayment of the capital.

6.If any portion of the indebtedness will be forgiven, written verification from the appropriate lender(s) must accompany the plan.

B.Check the financing plan for acceptability.



C.If the plan discloses that the financing arrangements are unsatisfactory as submitted or if the plan is not submitted within the required period:

1. Reject the application.\*

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- (3-7)\*      2. For a Section 223(f) project, reject the application for firm commitment and issue a conditional commitment if the case is otherwise acceptable and the conditional commitment stage was bypassed.

NOTE: If it is otherwise warranted, the Field Office can issue conditional commitment.

3-8.NET WORTH IN LIEU OF WORKING CAPITAL. If the financing plan indicates that fixed assets will be used to secure loans to cover the project's financial requirements, recommend approval based on "true net worth" rather than on working capital.\*

A.Fixed assets are those assets with an expected life greater than one accounting period.

1.They are recorded at their original cost, not their current value or replacement cost.

2.They include buildings, land, improvements (landscaping), equipment, vehicles, tools, furniture and other owned tangible property.

3.For fixed assets such as buildings, furniture, and equipment, there should be an allowance for depreciation that is deducted from the historical cost on the balance sheet to arrive at the "depreciated cost" or "net book value."

B.Before issuing a commitment, require the principal to provide a commitment letter from a lending institution that states:

1.The rate, amount, term and conditions, if any, of the loan that the lending institution is willing to provide.

2.The date by which the commitment letter must be exercised. (Must extend at least to the anticipated date for initial endorsement.)

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(3-8) 3. The party that will be responsible for repayment of the loan, if the commitment is exercised.

a.Repayment may not be an obligation of the mortgagor entity.

b.A certification indicating 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. This certification must contain the criminal warning reflected in paragraph 3-2.A.2. above.

4.The asset(s) that will be used as collateral to secure the loan.

3-9.LETTERS OF INTENT AND LETTERS OF CREDIT cannot be used to establish financial capability.

3-10.SPONSOR'S CONTINUING COMMITMENT. Pursuant to 24 CFR Section 200.215(e)(1), a principal is a public or private entity proposing to participate in a project as a sponsor, owner, prime contractor, etc. The analysis of the sponsor's financial capacity and the strength this capacity brings to the mortgagor entity is an integral part of the underwriting processing.

A.A written statement must be submitted from principals who are sponsors indicating the parameters of their financial commitment to and contractual relationship(s) with the mortgagor.

1.If the relationship is not intended to continue until the successful operation of the project, the financial requirements have not been met.

2.Any sponsor not having an ownership interest in the mortgagor entity must also certify in writing the amount it is willing to commit.

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(3-10) 3. Insert a special condition in the commitment 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 listed 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 commitment null and void.

B.Require closing documentation, i.e., organizational documents, reflecting such continuing contractual relationships. This documentation must also be reviewed by Field Counsel.

C.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:

1.At any stage through firm commitment, this is considered a significant deviation from the original concept and generally cause for rejection of an application.

2.After the issuance of the firm commitment, but before initial endorsement occurs, this is considered a significant deviation of the application for which the commitment was issued and may be cause for declaring the firm commitment null and void.

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(3-10) D. If a significant deviation is determined to have occurred based upon paragraphs B and C above, the Multifamily Division Director may require a new application and fee.

E.Individuals are prohibited from submitting financial statements as a sponsor and then abandoning the project and the mortgagor after the firm commitment is issued.

F.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 mortgagor could result in appropriate sanctions being taken (e.g., suspension, debarment).

3-11.EQUITY LOAN OBLIGATIONS. When the mortgagee or a third-party

source of insured loan funds (i.e., institutional investors, public limited partnerships and trusts that purchase mortgages, mortgage participations or GNMA mortgage-backed securities) is intending to provide equity loan funds to cover costs of the project that will not be funded from the insured loan, the following requirements must be met:

A.Repayment of additional funds may be made an obligation of the partner(s), other principal(s), or other third party, but may not be an obligation of the mortgagor entity itself.

B.The supplemental note evidencing the obligation to repay such additional funds may not be secured by a lien on the project.

C.The supplemental note may not require the repayment of additional funds from any project income (other than distributable surplus cash) or HUD-required project reserve.

3-12.\* GENERAL CONTRACTOR WITH ADEQUATE CAPITAL. The general contractor's adjusted working capital position should equal 5 percent of the estimated construction contract. \*

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(3-12)\* A.The instructions about hypothecation of fixed assets in paragraph 3-8 may be applied if the general contractor does not have an acceptable working capital position.

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

C.Adjust the working capital for projects underway.

D.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 percent of the estimated construction contract.\*

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