SMALL BUILDING RISK SHARING INITIATIVE

APPLICATION REQUIREMENTS

Lenders eligible to participate in the Small Buildings Risk Sharing Initiative (“the Initiative”) are Mission Based Lenders, defined to include high capacity Community Development Finance Institutions (CDFIs), other non-profit lenders, and public and quasi-public agencies, and Private Lenders (private, for-profit lenders approved as FHA Multifamily Accelerated Processing (MAP) lenders).

I. PRE-QUALIFICATION APPLICATION REQUIREMENTS

Applications submitted for participation in the Small Building Risk Sharing Initiative will be conducted in two stages, Pre-Qualification and Final Application. The first stage, described in this Section I, will address the fundamental organizational requirements for Mission Based and Private Lenders as well as preliminary tests of Financial Capacity. The Pre-Qualification application is to be completed by filling out the form provided in Exhibit 1, attaching supplementary materials described on the form, and delivering it to HUD. The Final Application is described in detail in Section II.

A. Organizational Requirements for Mission Based and Private Lenders

An applicant must demonstrate eligibility for the Initiative by providing evidence of 1) meeting any one of the following three organization descriptions, 2) meeting the test for affordable housing activity, and 3) making the certification below. Every applicant must meet all eligibility requirements on its own behalf. While an applicant may, for example, rely on the activities of subsidiary entities that the applicant controls, the applicant may not rely upon the activity of any other affiliated entities, including its parent company.

1. Organization Descriptions

   a. Mission Based Lenders (CDFIs): The applicant must be currently certified as a CDFI by
the CDFI Fund; or

b. **Mission Based Lenders (Non-Profit, Quasi Public or Public Agency Status):** The applicant must meet minimum criteria to qualify as a nonprofit, public, or quasi-public organization with lending for the preservation and development of affordable housing as one of its principal purposes. The organization must demonstrate that:

   i. It has been designated as a nonprofit or not-for-profit entity or public or quasi-public benefit corporation under the laws of the organization’s State of formation;

   ii. It is exempt from Federal income taxation pursuant to the Internal Revenue Code of 1986; and

   iii. Its incorporating documents, mission statements, or other board-approved organizational documents provide evidence that lending to promote the development or preservation of affordable housing is one of the organization’s primary purposes; or

c. **Private Lenders (For-Profit, Private Lenders):**

   The organization must be a for-profit private lender approved as, and in good standing with HUD as an FHA MAP Lender. “Good standing” will mean that the lender is in compliance with all FHA MAP program requirements, with no unresolved findings as a result of HUD or other governmental audit, investigation, or review. If HUD determines that a lender is not in good standing, whether as a result of lawsuits, cause determinations or letters of findings relating to discrimination and equal opportunity that have been issued or filed against the lender, or otherwise, and if these matters have not been resolved to HUD’s satisfaction by the time the application is submitted, the lender may be ineligible to participate in the Initiative.

---

1 CDFI certification requirements are more fully elaborated in the statute and the CDFI program regulations. See 12 U.S.C. 4702(5) and 12 CFR 1805.201.
2. **All Applicants: Recent Lending Experience for Affordable Housing Purposes**

All applicants must have demonstrable, recent experience in lending for the production and/or preservation of “affordable housing”, which for this purpose is defined as housing that meets the minimum requirements of the Risk Sharing Program. No less than 20 of all the applicant’s loans originated within the last 2 years of operations or 20 percent measured by dollars lent, must have had affordable housing as defined above as their primary purpose.

3. **All Applicants Must Certify That:**
   
a. The Department of Justice has not brought a civil rights suit against the applicant, and no such suit is pending;
   
b. There has not been an adjudication of civil rights violation in a civil action brought against the applicant by a private individual, unless it is operating in compliance with a court order, or in compliance with a HUD-approved compliance agreement designed to correct the areas of noncompliance; and
   
c. There are no outstanding findings of noncompliance with civil rights statutes, Executive Orders, or regulations as a result of formal administrative proceedings, or the Secretary has not issued a charge against the applicant under the Fair Housing Act, unless the applicant is operating in compliance with a consent order or in compliance with a compliance agreement with HUD designed to correct the areas of compliance.

**B. Financial Capacity**

1. **Minimum Financial Capacity Standards**

   All lenders under this Initiative must meet additional minimum financial capacity standards including standards with respect to net asset ratio, minimum net worth, earnings, loan loss reserves, and liquidity. Furthermore they must meet these standards independently, without reliance upon
informal or formal partnerships, joint ventures or any other relationship with related or unrelated organizations or sources of capital. Applicants must demonstrate that they have achieved each of the following:

a. **Minimum Net Asset Ratio and Net Worth Requirements.**

   This may be verified as described on the Small Buildings Risk Sharing Pre-Qualification Worksheet. QPEs must either have a minimum net worth of $7.5 million and a 20 percent net asset ratio, or have a minimum net worth of $7.5 million and a CAMELS composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (UFIRS)\(^2\) or equivalent nationally recognized rating system. QPEs are not required to have additional reserves so long as they maintain these required minimum standards. If the QPE can no longer meet these requirements, the QPE must comply with the provisions of paragraph “b” below. The applicant must immediately establish a reserve account funded as set forth in paragraph “b”. The reserve account must be computed on the basis of all loans in the QPE’s portfolio endorsed under the Risk Sharing Program.

b. **Dedicated Reserves.**

   A specifically identified dedicated account consisting entirely of liquid assets (i.e., cash or cash equivalents of readily marketable securities) must be established and maintained in a financial institution acceptable to HUD with assets of not less than $100,000,000; organized under the laws of the United States or a State thereof; and is regulated and examined by the

---

\(^2\) See [http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/bsp-2.PDF](http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/bsp-2.PDF). The Uniform Financial Institutions Rating System (UFIRS) was adopted by the Federal Financial Institutions Examination Council (FFIEC) in 1979 and revised in 1996. The rating system commonly referred to as the CAMELS rating system assesses six components of a bank's performance: Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. Composite and component ratings are assigned based on a 1 to 5 numerical scale. A 1 is the highest rating, and indicates strongest performance and risk management practices, and least degree of supervisory concern, while a 5 is the lowest rating, and indicates weakest performance, inadequate risk management practices and, therefore, the highest degree of supervisory concern.
Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation or the Federal Reserve Board, has a long term bank deposit rating of “A-1” or better by Moody’s Investors Service or “A+” by Standard and Poor’s. This account may be drawn upon by HUD and may be used by the QPE only with the prior written approval of HUD for the purpose of meeting the QPE’s risk-sharing obligations under the program. The account must be established prior to execution of the Risk Sharing Agreement (RSA) in an initial amount of not less than $500,000. Thereafter, the QPE must deposit at each loan closing and thereafter maintain the following additional amounts in the dedicated account:

i. $10.00 per $1,000 of the unpaid principal balance that is equal to or less than $50 million; plus

ii. $7.50 per $1,000 of the unpaid principal balance that is greater than $50 million and less than $150 million; plus

iii. $5.00 per $1,000 of the unpaid principal balance that is greater than $150 million.

The Commissioner may determine that higher levels of reserves may be necessary.

c. Evidence of Financial Solvency

This must be verified through disclosure of annual income, annual expenses and net income for each of the past 5 calendar years, and computation of a positive average net income from the best 3 of those 5 years. At Final Application, applicants must submit 3 years audited financial statements.

d. Thirty (30) Percent Loan Loss Reserve Ratio

A minimum 30 percent ratio of loan loss reserves to loans and leases 90 days or more delinquent, including loans sold with full recourse. (Any applicant not meeting this requirement can provide HUD with additional information demonstrating why, in the context of the business
conducted by that entity, its level of loan loss reserves is adequate for operating in a sound
financial condition.)

e. **Operating Liquidity**

An operating liquidity ratio of at least 1.0 for the four most recent quarters and for one or
both of the two preceding years, in which the numerator of the ratio includes unrestricted
cash and cash equivalents and the denominator of the ratio equals average operating expenses
for the period in question.

2. **Demonstration of Financial Capacity**

Applicants can demonstrate their financial capacity according to the requirements above by
providing:

a. A completed Exhibit 1, “Small Building Risk Sharing Pre-Qualification Worksheet”, and
b. A certification stating that there have been no enforcement actions, no criminal, civil, or
   administrative proceedings, and no liabilities, lawsuits, or judgments that would materially
   hinder financial feasibility.

II. **FINAL APPLICATION REQUIREMENTS**

All applicants must be able to effectively cover their share of the transaction risk in the event
of a claim. They must also provide HUD with confidence that they have a successful track record
of loan underwriting and loan performance, because the 542(b) Program delegates underwriting and
monitoring activities to the QPE. The following requirements apply:

A. **All Lenders under this Initiative must be approved as FHA lenders.**

FHA classifies approved mortgagees based on the functions they will perform and type of
organization. Mission Based Lender applicants must deliver verification of submission of a
complete FHA Lender Application as part of their Final Application if they are not already
approved as FHA Non-supervised Mortgagees. Note: The FHA Lender Application is to be submitted online, separate from the program application. Complete details regarding the FHA lender approval process are in Handbook 4060.1, Rev-2 at:

http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips. An FHA Lender Approval Application, Form 92001-A, can be downloaded from HUD’s website at: http://portal.hud.gov/hudportal/documents/huddoc?id=92001-a.pdf. To become an FHA lender, applicants must have a minimum adjusted net worth of $1,000,000 and meet other standards, submit audited financials to verify compliance; and the officer who will be in charge of the FHA operation must have at least 3 years of experience in FHA mortgage operations, or 1) provide evidence of comparable experience acceptable to HUD in affordable housing lending and mortgage insurance operations, and 2) have no concurrent outside or self-employment in the mortgage or real estate industry or related field. Note: Private Lenders must be FHA MAP Lenders in good standing in order to apply under this Initiative, therefore separate FHA Lender applications are not required.

B. All Applicants (Mission Based and Private Lenders): Application Narrative

All applicants, Mission Based and Private, must submit a narrative of no more than 20 pages addressing the items described below. Applicants should craft responses that clearly address any issues with respect to the minimum financial capacity standards set forth in the Pre-Qualification Worksheet. Responses should also summarize the detailed information that may be found in the applicant’s operating, administrative and quality control documentation.

1. Organizational History

3 Additional requirements of FHA Lender applications can be found on HUD’s website: http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/lender/lendappr
Describe the history and organizational background of the applicant. Indicate how long the applicant has been in existence, the applicant’s mission, when the applicant began to finance multifamily loans, and an overall description of its multifamily lending activities.

2. **Portfolio List**

   Provide a list as an exhibit with the applicant’s properties financed within the past 10 years. The list must include: type of project (family, assisted living, cooperative, or non-multifamily), unit count, and type of loan (first mortgage, second, gap loan, credit support, new construction, rehabilitation, refinancing with or without repairs, etc.) Include original mortgage amounts, outstanding principal balances, status (current, in default, foreclosed, in workout) and location (urban/suburban/rural).

3. **Staff Capacity**

   Provide a staff list with resumes as an exhibit. The list should include loan processing, management and technical staff (e.g., architects, engineers, construction inspectors, cost analysts, mortgage credit analysts, underwriters, appraisers, market analysts, loan management, servicing, asset management and property disposition personnel).

4. **Use of Contract Personnel**

   If any of the above mentioned functions are performed by contract personnel, provide the applicant’s qualification requirements for such contract services, procedures to monitor performance, evaluate work products, and the experience of the applicant personnel responsible for the monitoring and evaluation of contract services.

5. **Counsel**

   Provide a list as an exhibit of counsel on staff, or retained by the applicant with their experience in real estate transactions.
6. **Summarize the Applicant’s Technical Capacity in the following areas:**

a. **Architect, Engineering and Cost Services:** Summarize the applicant’s review of plans and specifications. Summarize construction inspection procedures, requirements for project completion, guarantee/warrantee/latent defect inspections, and the process and criteria for releasing advances. Summarize the controls in place to ensure quality work performance and products, whether performed by in-house staff or contractors.

b. **Valuation.** All appraisal functions must be completed by Certified General Appraisers, licensed in the State in which the property is located. All appraisal functions must also be completed in accordance with the Uniform Standards of Professional Appraisal Practice. Summarize the applicant’s appraisal controls to ensure quality work performance and products, and staff’s authority to make changes in the appraisal documents and/or conclusions.

c. **Market Analysis.** Summarize the applicant's practice for ensuring that a market exists for the proposed project. State whether the applicant conducts its own market analyses or relies upon studies submitted by the developer/sponsor. State whether or not the applicant’s practice deviates from that recommended by the National Council of Housing Market Analysts.

d. **Mortgage Credit.** Summarize the mortgage credit, origination and underwriting policies, procedures, and approval processes. Summarize how and under what conditions, the analyst's recommendations or findings may be modified. Describe the applicant's controls to ensure quality performance.

e. **Environmental.** All projects insured under the 542(b) Risk Sharing Program must comply with the environmental requirements of 24 CFR Part 50, and it is anticipated that QPEs will use
consultants for this purpose. Describe the qualifications of the environmental consultants responsible for supplying environmental information and analysis to HUD. Any specializations in subjects such as Historic Preservation should be noted. Environmental consultants should have experience in preparing Environmental Reports in accordance with FHA’s MAP Guide. The Phase I Environmental Site Assessment (ESA) must be prepared by an Environmental Professional as described in ASTM E 1527-05 (or most recent edition.) Summarize the controls in place to ensure quality work performance and products.

f. **Cost Certification.** Summarize the cost certification process and its controls to ensure that costs are legitimate, absent fraud and misrepresentation, and that all project improvements are in place prior to accepting the certification. Indicate how the cost certification process addresses mortgage excesses and if there are mandatory mortgage prepayments.

g. **Loan Approval.** Summarize the loan approval process and indicate whether a loan committee or similar body that approves loans (including the board of directors), can override the underwriter’s recommendations. Describe under what circumstances and what documentation is required to support the override. Describe the composition of the Committee. If there is a minimum loan amount or other circumstances under which loans are not referred to Committee, describe the circumstances and describe that approval process.

h. **Loan Servicing and Asset Management.** Summarize the policies, processes and procedures utilized to support all servicing activities (in-house or contract) including the monitoring of compliance with regulatory agreements, physical property inspections, management of borrower bankruptcies, claim filings, foreclosures, workouts and asset dispositions. Summarize the applicant's requirements for project audits and reviews, and procedures for the resolution of
management review and financial audit deficiency findings. Summarize asset management’s reports used to monitor loan performance, delinquencies, foreclosures and servicing issues.

i. **Loan Monitoring and Workout Procedures.** Summarize loan monitoring and work out policies, processes and procedures, including reporting, borrower contact and follow up and any other related activity. Summarize workout plans the Applicant has implemented during the last 5 years, and how well that project is performing against the workout plan. If an applicant has had no experience with workouts, describe how a workout plan would be developed and identify any tools or strategies the agency would propose to use to establish the elements of a workout agreement.

j. **Investment Policies.** Summarize how investment decisions are made and how procedures in place to generate and monitor financial reports, changes in fund balances, and changes in financial position. Describe procedures in place for the prompt notification to HUD of negative changes in the applicant's financial position.

**C. Exhibits To The Final Application**

The following are required from all applicants:

1. **Manual(s)**

   A copy of the applicant's administrative manual(s) or other documentation describing the applicant’s investment policies and overall business and financial practices.

2. **Certification**

   A certification from the applicant that it will at all times comply with the financial requirements for this Initiative and, where applicable, maintain required reserves in a dedicated account in liquid funds (i.e. cash, cash equivalents, or readily marketable securities) in a financial institution acceptable to HUD.
3. **Financial Statements**

Copies of audited financial statements for the applicant’s last 3 fiscal years, and a written disclosure of any material changes in financial positions that have occurred since the latest financial statement. Financial statements must include the organization’s contingent liabilities. Compiled financial statements are not acceptable. HUD reserves the right to request additional information from the applicant in order to verify that it has satisfied these requirements. Applicant will promptly supplement the application with any relevant information that comes to applicant’s attention prior to HUD’s decision on whether to approve or deny the application.

4. **Sample debenture form issued by the Applicant**

“Debenture” means the instrument issued by the QPE to HUD upon payment of an insurance claim by HUD. The instrument must be in the standard form of a State or Municipal Debenture issued under the Uniform Commercial Code, where applicable, and must be supported by the full faith and credit of the QPE. The instrument must define the terms and conditions and the risk sharing portion which the QPE will pay at the end of the term of the Debenture, and must be for the full amount of the claim payment. The term Debenture may include similar instruments, such as promissory notes and bonds, as mutually agreed upon by the Commissioner and the QPE.

5. **Portfolio List** as previously described in Section II.B. 2

6. **Counsel List** as previously described in Section II.B. 5

7. **Applicant’s Staff List** as previously described in Section II.B. 3

Application materials received by HUD will not be returned, will be held in strict confidence in accordance with applicable laws and regulations.

### III. EXHIBIT

Small Buildings Risk Sharing Pre-Qualification Worksheet