

Chapter 6
Participant Credit and
Financial Review

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6.1

**Determining Acceptability of the Borrower,
Operator, Parent of the Operator, 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 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~~the Borrower, Operator, parent of the Operator, 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 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 and general contractor.
4. Determine the financial capability of the Borrower and the general contractor.

38
39 Take a holistic 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 creditscharacter 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.

45 46 B. Terrorism Checks and Verifications

47
48 Terrorism checks and verifications on all principals are required by the USA Patriot Act. These
49 checks must be completed and documented prior to Initial Endorsement of the FHA-insured
50 loan, regardless of whether or not the Lender is a regulated financial institution. The Office of
51 Foreign Assets Control of the United States Department of Treasury administers and enforces
52 economic and trade sanctions based on US foreign policy and national security goals.
53 Information and guidance on the requirements of the Patriot Act can be found on the
54 Department of Treasury's website: <http://www.ustreas.gov>.

55
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 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.

72
73 Individuals who satisfy the Controlling Participant requirement may not be removed from
74 identified principal or controlling participant entities without prior HUD approval.

75
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:

- 79
80 1. General Partnership (GP);
- 81
82 2. Limited Partnership (LP);

- 84 3. Corporation, C corporation, S corporation;
85
86 4. Limited Liability Company (LLC);
87
88 5. Trust;
89
90 6. Non-profit corporation;
91
92 7. Any other public or private single-asset borrower entity; however, the FHA-insured
93 property may not be owned by a natural person or as tenants in common;
94
95 8. Any combination of ownership forms can be used to establish a joint venture, for the
96 purpose of jointly sharing the risks and the rewards by contributing the appropriate
97 knowledge, skills, or assets that are necessary for a successful development project.
98 However, a single-asset borrower entity is always required.
99

100 D. **Foreign national and corporate entity participation.** Generally, foreign nationals and
101 corporate entities may participate as either Active or Passive Principals. However, the
102 single-asset borrower entity must be registered in the United States in the state where their
103 corporate office is located and at least one Principal, with operational decision-making
104 authority, must be a United States citizen, or a foreign national who is a lawful permanent
105 resident of the United States, having an immigration status granted by the United States
106 government that enables the Principal to exercise operational decision-making authority.
107 Each foreign national individual or foreign national controlled private entity that is an Active
108 or Passive Principal must be listed on the Borrower’s organizational chart. Individuals who
109 satisfy the Controlling Participant requirement for a presence in the United States may not be
110 replaced without HUD approval.

111 ~~Where eligible to do so, foreign~~Foreign participants must obtain an international tax
112 identification number (“ITIN”) from the Internal Revenue Service. The U.S. domiciled,
113 controlling participant will be a named party in paragraph 38 of the appropriate Regulatory
114 Agreement. Information on the process to obtain an ITIN is available at: <http://www.irs.gov>.
115
116

117 E. ~~Identifying the principals: A principal is a public or private entity proposing to participate~~
118 ~~in a project as a Borrower, Operator, parent of the Operator, Management Agent, general~~
119 ~~contractor or the like. A principal can have an active role in a project and direct the activities~~
120 ~~and affairs of the borrower entity or be involved in decision-making; or a principal can have~~
121 ~~a passive role where the principal’s participation is limited to an ownership interest in the~~
122 ~~project.~~**Identifying the principals:** All principals must be identified and analyzed based on
123 their experience, creditworthiness and financial histories.
124

125 **1. Principals: “Principals” are:**

- 126 a. ~~The borrower entity, any entities and individuals with a significant ownership~~
127 ~~interest in the borrower entity (as described below), and any affiliate (whether~~
128 ~~individual or entity) of the borrower entity or any of the individual or entities with~~
129 ~~a significant ownership interest. For partnerships, all general partners are~~

principals, and limited partners having a 25% or more interest in the partnership are principals. If the principal is a corporation, all operating officers, all officers of the board of directors, and each stockholder having a 10% or more interest in the corporation are principals, and all limited partners having a 25% or more interest in the corporation are principals. For non-profit corporations, principals include officers of the board of directors and any staff members who are designated by the corporation as corporate officers.

b. All managers and managing members of LLCs are principals and all members that have a 25% or more interest in the LLC are principals. A member is an owner of the LLC and is similar to a stockholder in a corporation. A manager is a person chosen by the members to manage the LLC and is similar to a director of a corporation. A manager can also be a member.

c. General contractors.

d. Management agents (*Note: the Lender does not have to conduct a financial and credit analysis of a management agent.*)

e. Packagers, and other persons or organizations hired to furnish advisory services in connection with project financing, construction or operation are principals even if the services provided are limited to selecting and negotiating contracts with contractors, architects, attorneys or managing agents; or to negotiating contracts to secure financing for the project; and

f. Consultants (except for architects and attorneys that are engaged in an arm's length cash fee arrangement to provide professional services for a project and who do not have an ownership interest or a management role, or who do not participate in other ways as a principal in the project).

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

a. Stockholders with less than 10% interest in a corporation;

b. Limited partners with less than 25% interest in the partnership;

c. Attorneys and architects with only an arms-length fee arrangement to provide services for a project;

d. Minor corporate officers;

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

175 *have effective control of trust assets should be treated as principals. The Lender Narrative*
176 *should explain the Lender's identification of trust principals.*

177
178 Principals are defined by the Controlling Participant definitions as set forth in 24 C.F.R.
179 §200, Subpart H; Housing Notice H 2016-15, and any successors thereto.

180
181 **F. Parent of the Operator:** A parent company is a company that has a controlling interest in
182 another company, giving it control of its operations. Parent companies can be either hands-on
183 or hands-off owners of their subsidiaries, depending on the amount of managerial control
184 given to subsidiary managers, but are always considered to maintain a certain level of active
185 control. Operator entities proposed for FHA-insured financing may be identified as having a
186 parent entity when one or more of the following conditions exist: a) individual facility
187 financials are consolidated into a larger financial statement and/or audit; b) there are
188 individuals in common who have been previously identified as having a Controlling
189 Participant role in other FHA-insured projects; c) there is group branding among projects; d)
190 consolidated operations exist among multiple facilities; or e) the parent entity qualifies as a
191 Controlling Participant under 24 C.F.R. §200, Subpart H and Housing Notice H 2016-15.

192
193 Regardless of whether or not 24 C.F.R. § 200, Subpart H, and Housing Notice H 2016-15
194 considers the Parent of the Operator to be a controlling participant for previous participation
195 review purposes, the lender is required to complete a financial capacity, creditworthiness and
196 character review of Parent of the Operator entities associated with Section 232 projects.

197
198 **F.G. Liability:** Section 38 of the Healthcare Regulatory Agreement – Borrower (Form HUD-
199 92466-ORCF), Nonrecourse Debt, requires that individuals or entities who will be personally
200 liable for certain enumerated matters be identified within the document. This is done by
201 reference to the “Section 38 Addendum, which is attached to the document.

- 202
203 1. For privately held entities: Section 38 generally requires two signatures ~~for~~from
204 project ~~sponsors~~principals. In most cases, HUD, upon the Lender's recommendation,
205 shall select one individual signatory to sign in his or her individual capacity and the
206 project parent/~~sponsor~~ entity to sign in a corporate capacity. In any specific deal,
207 underwriting may point to a different entity with the requisite control and
208 involvement or interest in the Project, positive credit history, and adequate financial
209 strength relative to the size of the loan to serve in the capacity required by Section
210 38.
- 211 2. For publicly traded corporations or REITS, or Non-profit organizations: The
212 parent/sponsor entity itself is acceptable as the sole signatory. For such entities, any
213 individual signing on behalf of the corporate entity does not sign in an individual
214 capacity, but to bind the parent/sponsor, and no personal liability will be claimed
215 against the individuals signing in such a capacity.
- 216 3. For any corporate entities required to execute Section 38: Every corporate officer is
217 not required to sign. Whomever the corporation entity has authorized to bind the
218 company in connection with the proposed transaction may sign, provided that ORCF,

- 219 upon considering the Participant Credit and Financial Review, has discretion to
220 require additional signatories if warranted in a specific (exception) situation.
221 4. If state or local law requires these signatures to be notarized in order for Section 38 to
222 be enforceable or for recordation purposes, then the signatures are to be notarized.
223 5. Please note the following prohibitions related to Section 38:
224 a. Insertions of "or successors" language to the identification of signatories is
225 NOT allowed. The Regulatory Agreement can and should be amended when
226 there is a new individual who is responsible for the provisions of Section 38.
227 b. Riders to the Regulatory Agreement that attempt to limit a signatory's liability
228 are NOT allowed.
229 c. Section 38 may not be omitted because a project has been processed as an (a)7
230 versus another section of the Act.
231 6. It is the Lender's responsibility to perform the Participant Credit and Financial
232 Review of the parent/~~sponsor~~ entity and to identify and justify who has been proposed
233 to sign Section 38 of the Regulatory Agreement.

234
235 ~~G. **Controlling Participants for Previous Participation Review Purposes.** Controlling~~
236 ~~Participants for Previous Participation review purposes may or may not be the same as the~~
237 ~~principals for credit review purposes. See Housing Notice H 2016-15 (or successors thereto)~~
238 ~~for additional details on who must file a previous participation certification.~~
239

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

247
248 A commercial credit report for a business or a residential mortgage tri-merge or tri-merge
249 plus type credit report for individuals must be current within 60 days of the application
250 acceptance date and the Office of Residential Healthcare Facilities ("ORCF") may require
251 updated reports during processing. Credit investigation, including analysis of credit reports
252 are, is required on:

- 253
254 1. The borrower and controlling participants.
255
256 2. The facility operator and controlling participants.
257
258 3. The parent of the operator and controlling participants.
259
260 4. The general contractor entity, if formed, before submission of an application.
261 However, ORCF does not require credit reports or investigation of the individual
262 Controlling Participants of the general contractor.
263

264 ~~2. Principals of the Borrower as defined in Section 6.1H above. (Note: If a principal is~~
265 ~~a business entity, i.e., corporation, partnership, limited partnership, with an~~
266 ~~operating history, a credit report is required only on the business firm, not the owners~~
267 ~~or partners of the firm.)~~

268 5. ORCF does not require credit reports or credit investigation for the Management
269 Agent or the individual Controlling Participants of the Management Agent.

270
271 6. 10%, up to a maximum of 10, of the borrower's other business ventures as selected
272 by the Mortgagee.

273
274 ~~3.7.~~ All businesses with pending judgment(s), legal action(s), lawsuits, or bankruptcy
275 claims.

276
277 ~~4. 10%, up to a maximum of 10, of the sponsor's other business ventures as selected by~~
278 ~~the Mortgagee.~~

279
280 ~~5.1. The facility operator.~~

281
282 ~~6. The parent of the operator.~~

283
284 ~~7. The general contractor.~~

285
286 ~~8. The housing consultant, as applicable, for non-profit transactions.~~

287
288 ~~9. A credit review of members of public and non-profit boards of directors is not~~
289 ~~required unless the board member is also a board officer with an operational decision-~~
290 ~~making role over the property.~~

291
292 **I. Lender's review of the credit report.**

293
294 1. The Lender may obtain a Dun & Bradstreet or similar commercial credit report for
295 business entities and a ~~residential credit report~~ tri-merge or tri-merge plus type for
296 individuals. An acceptable commercial credit report should include public filings
297 (lawsuits, liens, judgments, bankruptcies and federal debt; Uniform Commercial Code
298 (UCC) filings; credit payment history; financial stress/payment trends compared to
299 industry standards; and a credit payment delinquency risk score over a twelve month
300 period.

301
302 2. The Lender should compare all information obtained from credit reports and credit
303 histories to the financial statements provided by the relevant Borrower or principal(s).
304 Any contradictory information should lead to further inquiry until the evidence shows
305 a consistent and complete picture.
306

- 307 3. The Lender should make reasonable inquiries to determine if the applicant or any
308 principal is in default on any federal debt (i.e., direct loans, FHA-insured loans,
309 student loans, and Small Business Administration loans) or any judgment liens
310 against the property for a debt owed to the federal government.
311
- 312 4. The Lender should determine if the information is incomplete, or if there are
313 inconsistencies or discrepancies between the information included in the financial
314 statements and the information in the credit reports and resolve those inconsistencies
315 or discrepancies.
316
- 317 5. The Lender should investigate any adverse credit information that appears on the
318 credit report or adverse character information that becomes known from making
319 inquiries of bank and trade references and of other HUD offices. The Lender must
320 require a written explanation of any late payments, adverse actions, judgments or
321 other derogatory information found in their investigation.
322

323 The

324 6. lender should affirmatively conclude, in writing, that a principal's current credit
325 investigation findings and financial history are acceptable for participation in HUD
326 programs.
327

328 J. **Delinquent federal debt:** When a delinquent federal debt exists, the Lender shall include as
329 part of the required application exhibits:

- 330
- 331 1. a detailed written explanation from any applicant or principal with a prior federal
332 default or claim or whose credit report and financial statements contain conflicting or
333 adverse information.
334
- 335 2. a letter from the affected agency, on agency letterhead, signed by the appropriate
336 agency officer, stating that the delinquent federal debt is current or that satisfactory
337 arrangements for repayment have been made.
338
- 339 3. the Lender's reason(s) for recommending the applicant, which may be included in the
340 Lender Narrative.
341

342 K. **Additional review:** In addition to the formal documents and credit investigation described
343 above, the Lender's underwriter must conduct and describe the results of a thorough internet
344 search of each principal and determine if there are any citations or character issues which
345 raise concerns about creditworthiness or reputational risk to the Department of any principal.
346

347 The lender must provide evidence that principals in a transaction are of strong
348 character. Principals with prior convictions of fraud, or other types of activities indicative of
349 poor character or reputational risk to the Department, particularly but not exclusively related
350 to healthcare facilities, may not be eligible for the Section 232 program. This review is in
351 addition to the Previous Participation requirements in 24 C.F.R. § 200, Subpart H and

352 Housing Notice 16-15.

353
354 L. **Rejection because of unacceptable credit.** ~~The~~ or other perceived risk. Lenders should
355 use ~~its~~ professional judgment when approving or rejecting a principal based on the applicable
356 principal's creditworthiness ~~and character.~~ The individual may be rejected if:

- 357
- 358 1. the credit investigation evidences that the principal has a history of not paying
359 creditors in a timely manner ~~or~~, lacks liquidity or is of questionable character.
 - 360
 - 361 2. any delinquent federal debt has not been resolved or satisfactory arrangements for
362 repayment have not been made.
 - 363
 - 364 3. There are judgments or actions against the principal that:
 - 365 a. could significantly impact upon the financial position of the individual/ firm
366 or corporation.
 - 367 b. result in a determination that the individual, firm or corporation is an
368 unacceptable credit risk.
 - 369 4. ~~the~~The principal is insolvent or is the subject of a pending bankruptcy or insolvency
370 proceeding at the time of application, firm commitment, or at the time of loan closing.
371 [Note: The Lender should update credit reports or investigations at firm commitment
372 and prior to closing]

373

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

382

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

394

395 6. If a principal is found unacceptable or ineligible for participation in a project,
396 regardless of whether or not the principal has other ongoing involvement in other

FHA-insured transactions, a familial relation, regardless of financial capacity or experience, may not be inserted into the position of the of the principal who is determined to be unacceptable.

M. **Analyzing the Borrower, Operator, parent of the Operator 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.
2. the geographic area, market, and particular regulatory environment of business involvement.
3. the length of time of the principal's involvement with development, lease-up, ownership and operation of residential healthcare facilities.
4. past roles performed by each principal in the residential healthcare business.
5. For new construction, the past history of the proposed development team (borrower, operator, management agent, as applicable) in working together to successfully develop healthcare facilities of a similar bed size and acuity level should be demonstrated.

Each resume should demonstrate the level of experience and sound character needed to successfully complete the development of the proposed project. The Lender should identify new Borrowers whose primary business is not healthcare facility development or operations, that have little residential healthcare experience, or that are new to a particular market or state regulatory environment. It may be necessary to inspect a sample of the new Borrower's real estate holdings to determine the quality of the assets and management of the Borrower's existing portfolio. The Lender should explain any identified risks in the Borrower's existing portfolios. The Lender may require that the Borrower bring in additional members to the development team to satisfy the experience requirements.

440 2. Any principal found to have an outstanding violation of the Fair Housing Act by the final
441 determination of an administrative agency or court is ineligible under this section, unless
442 the principal is operating under a remedial order or agreement.
443
444

6.2

Participant Financial Review

445 A. Financial statements give a picture of the financial position of an individual or a /company at
446 a certain point in time and provide: historical information for measuring and evaluating the
447 financial performance of a principal or a firm, and advance warning of financial problems.
448 Lenders should use the information in financial statements to determine if the Borrower,
449 Operator, parent of the Operator and/or their principals have the financial capacity to develop,
450 build and complete and operate the project, and whether the general contractor has the ability
451 to deliver the project based on their respective:
452

- 453 1. past financial condition;
- 454 2. present liquidity;
- 455 3. projected future financial capacity.

456 The Lender must complete a financial review to determine the amount of funds available for
457 investment in the project by performing an analysis of the working capital for a proposed project.
458 Working capital is the difference between current assets and current liabilities and may be used to
459 purchase assets, pay off debt and make up deficits from operations. The financial analysis also
460 determines which non-pledged, unsecured assets can be readily hypothecated to secure the
461 proposed FHA-insured loan.
462

463 B. ~~B.—Exhibits:~~ The Borrower, Operator, parent of the Operator, and general contractor must
464 furnish current financial statements with supporting schedules as part of the application for
465 commitment processing.
466

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

- 475 1. Individuals must submit either:
 - 476 a. a complete Personal Financial and Credit Statement (Form HUD-92417):
 - 477 i. the spouse of married sponsors or principals must also sign the form.

- 483 ii. if a spouse's signature cannot be obtained, the principal must prepare
484 the form reflecting only those assets that are solely in the principal's
485 name and any liability, including those joint liabilities, for which the
486 principal is responsible; or
487 b. a substitute statement that contains, at a minimum, the information contained on
488 the Personal Financial and Credit Statement. The statement must contain the
489 following certifications and criminal warning:
490

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

497 Signed this ____ day of _____, 20___. Signature of authorized agent with
498 name printed or typed under signature _____.

499 ~~Warning – HUD will prosecute anyone who knowingly submits a false claims~~
500 ~~and statements. Conviction may result in claim or makes a false statement is~~
501 ~~subject to criminal and/or civil penalties-, including confinement for up to 30~~
502 ~~years, fines, and civil and administrative penalties. (18 U.S.C.~~
503 ~~§§ 287, 1001, 1010, 1012, 1014; 31 U.S.C. §§ 3729, 3802).~~
504

505 For married individuals, the spouse also must sign the certification.
506

- 507 2. Business entities must submit separate statements and supporting documents, set forth
508 below, for the last three (3) years or the length of their existence. If the entity has
509 been in existence less than three (3) 3 years, an authorized officer of the organization
510 must provide the statements and supporting documents with a signed statement that
511 there has been no material adverse change since the date of the statements.
512 a. Balance Sheet that:
513 i. provides a breakdown of current and non-current assets;
514 ii. identifies restricted and non-restricted funds;
515 iii. provides a breakdown of current and non-current liabilities;
516 iv. identifies the current portion of long-term debt; contingent liabilities,
517 including debts under secured or unsecured lines of credit or letters of
518 credit, personal guaranties, obligations to limited partnerships and
519 other obligations payable in the future, including the amount and
520 duration of the obligation; and
521 v. lists details of any factors that may materially affect the Borrower's or
522 sponsor's financial position now or during the term of the proposed
523 FHA-insured mortgage.
524 b. Income and expense statement that reflects:
525 i. income from normal operations;
526 ii. investment income;
527 iii. other income; and
528 iv. total expenses.

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- 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.
 - iii. schedule of pledged assets, if applicable, identifying each pledged asset, the amount pledged and the offsetting liability.
 - iv. schedule of marketable securities that provides: name, number of shares, current market values as of the date of the statement, and the exchange where the shares are listed.
 - v. schedule of accounts payable that provides: name, type of account (trade, affiliate, employee, relative or other), payment terms, amount and aging information.
 - vi. schedule of notes and mortgages payable that provides: 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 amount.
 - vii. schedule of legal proceedings, if applicable.
 - viii. in addition to the applicable schedules set forth in subparagraphs 1-7 above, general contractors must submit a schedule of jobs (work) in progress that identifies, for each job, the:
 - a. original contract price;
 - b. construction start date;
 - c. construction completion date; and
 - d. percentage of completion.
 - e. combined or consolidated financial statement(s), if applicable.
 - e. Other financial data necessary to determine the financial responsibility and capacity of the Borrower, Operator, parent of the Operator and their respective principals, and the general contractor,
 - f. The certification must be signed and dated by an authorized official of the company. The certifications must reference the name of the business and the date of the financial statement(s).
3. **Section 223(f) project financial statements:** The proposed BorrowerControlling Participant must submit financial statements for the last three (3) fiscal year of the project and if more than three (3) months have expired since the closing date of the financial statements, a year-to-date balance sheet and operating statement. If financial statements are not available due to circumstances beyond the Borrower'sControlling Participant's control, the BorrowerControlling Participant must submit:

- 575 a. evidence satisfactory to the Lender that the financial statements are not
576 obtainable;
- 577 b. project financial statements that are available including an owner-certified
578 balance sheet and operating statement and
- 579 c. in all cases, the past three (3) years of tax returns for the property and the
580 borrower entity.
- 581
- 582 4. The BorrowerControlling Participant must certify any financial statement or balance
583 sheet and operating statement, each of which must include the criminal warning set
584 forth in Section 6.2.B.1.b(3) above.
- 585
- 586 C. If the financial statements are not available, the Lender's case file must contain a statement
587 from the BorrowerControlling Participant that explains why all the required records are not
588 obtainable and a memorandum from the Lender to the ORCF stating that the Lender has
589 evaluated the Borrower'sControlling Participant's statement and agrees that the information
590 is not available. **Processing financial statements and other documents:** A financial
591 statement is considered current if it is no more than three (3) months old when the application
592 is submitted by the Lender for firm commitment review. ~~The Lender must determine~~
593 ~~financial stability and financial strength, unless the Borrower and sponsor is a public~~
594 ~~company with an investment-grade credit rating.~~ The Lender's review should take the
595 following factors into account:
- 596
- 597 1. The credit investigation or other circumstances may warrant more current financial
598 statements; therefore, the Lender should:
- 599 a. assess the adequacy of each participant'sControlling Participant's liquidity
600 and ability to provide immediate and ongoing support to the project, as well as
601 to any asset that is in financial difficulty.
- 602 b. review other sources of sponsorthe Controlling Participant's cash flow in the
603 analysis, if the source and stability of the cash flow has been verified by
604 reviewing historical ~~tax returns, financial statements.~~ Interest income from
605 notes receivable, real estate investment income, dividend income, and
606 ~~sponsorthe Controlling Participant's~~ salaries should not be included.
- 607 c. review audited or reviewed financial statements prepared by a CPA or IPA
608 that are up to one (1) year old. Audited or reviewed statements must be
609 supplemented with updated interim financial statements and supporting
610 documentation, which may be management-prepared, if more than six (6)
611 months have lapsed since the closing date of the audited statement.
- 612
- 613 2. The Lender should review the financial statements of the participantsControlling
614 Participants and the general contractor to determine the amount of working capital
615 available for the project. The net working capital should be adjusted to reflect
616 contingent liabilities and the financial needs of other projects undertaken by the
617 participantsControlling Participants and the general contractor that are in the planning
618 stage or under construction, as applicable.
- 619

- 620 3. The Lender should recommend that a loan be approved based on the “true net worth”
621 of a participantControlling Participant rather than on working capital. Existing assets,
622 not working capital should be used to secure the FHA-insured mortgage loan. The
623 Lender should review existing assets, loans and lines of credit. The Lender should
624 require the participantControlling Participant to provide a commitment letter from a
625 lending institution that states:
- 626 a. the rate, amount, term and conditions, if any, of the loan that the lending
627 institution is willing to provide.
 - 628 b. the date by which the commitment letter must be exercised; the date must
629 extend at least to the anticipated date for initial endorsement.
 - 630 c. the party that will be responsible for repayment of the loan or line of credit, if
631 the commitment is exercised. Note that: repayment may not be an obligation
632 of the borrower entity.
- 633 The letter must include a certification indicating that the lending institution will not
634 make any claim against the mortgaged property, mortgage proceeds, any reserve or
635 deposit required by ORCF, or against the rents or other income from the mortgaged
636 property for payment of the loan or line of credit. This certification must contain the
637 criminal certification set forth in Section 6.2.B.1.b (3) above.
- 638
- 639 4. Funds provided by a parent company or affiliate of the participantControlling
640 Participant require a certification from the board of directors or an authorized agent
641 that specifies the amount of funds that the parent company or affiliate will commit to
642 the project. The Lender should determine the availability of funds from the parent
643 company or affiliate and consider whether:
- 644 a. individual corporations have any excess operating capital.
 - 645 b. the laws under which the entity is incorporated or its exiting lenders permit:
 - 646 i. withdrawals, loans or advances to owners or sponsors;
 - 647 ii. stock investment in affiliated corporations; and
 - 648 iii. guarantee of debts of associated corporations.
- 649
- 650 5. Letters of intent and letters of credit cannot be used to establish financial capability.
651 At initial endorsement, however, letters of credit may be substituted for cash to set up
652 many of the escrows required at initial and final endorsement, or during construction.
653 If a participant draws down cash at initial closing to satisfy escrow requirements, a
654 letter of credit cannot be substituted to establish the same escrow requirements.
655
- 656 6. Individuals are prohibited from submitting financial statements as a
657 participantControlling Participant and then abandoning the project and the Borrower
658 after the firm commitment is issued. The Lender should require a certified statement
659 from the participantControlling Participant stating the participant’s commitment to
660 the project and specifying the amount of funds that will be reserved for contingent
661 needs through final closing and sustaining occupancy.
662
- 663 7. The submission of a financial statement that is used to influence Federal Officials
664 concerning a mortgage insurance risk determination when the participantControlling
665 Participant does not plan a continuing relationship with the Borrower could result in

666 appropriate sanctions being taken against the sponsor including suspension or
667 debarment.

668
669 8. General Contractor with adequate capital: The general contractor's adjusted working
670 capital position should equal five percent (5%) or more of the estimated construction
671 contract for the project.

672
673 If the general contractor does not have an acceptable working capital position, the
674 general contractor's fixed assets may be hypothecated. The general contractor's
675 ability to obtain a performance and payment bond does not negate or lessen this
676 requirement.

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

6.3

Evaluating Non-profit Borrowers and Participants

686
687 A. **General:** Non-profit Borrowers (whether national, regional, or local) must have the
688 experience and financial strength appropriate for the development and ownership of the
689 proposed property. This section of the Handbook sets forth the criteria for making an
690 evaluation of the experience and strength of non-profit Borrowers. The non-profit Borrower
691 being evaluated may not have equal strength in all categories. In transactions where the
692 ownership structure involves multiple entities performing different functions, the Lender
693 should evaluate the non-profit Borrower and each of the other entities and their capacity to
694 perform a particular function (e.g., ownership, property management operations, acquisition,
695 development, resident services or asset management). Entity participants/principals should
696 have a prior acceptable history of successful development, ownership and management of
697 assets that are similar in bed/unit size, and healthcare acuity complexity as the proposed
698 project. Therefore, only the criteria for the areas for which the non-profit entity has direct
699 responsibility or authority should be reviewed during the evaluation process. The Lender
700 must include in the application:

- 701
- 702 1. the Developer's Agreement or any other document which shows the relationship and
703 responsibilities of all parties associated with the transaction.
 - 704 2. the housing consultant's contract, if applicable.
 - 705 3. a memorandum of findings and recommendations which includes:
706
707

- 708 a. a description of the relationship between the non-profit and any profit-
709 motivated entities involved in the transaction;
710 b. the determination of eligibility or ineligibility of the non-profit
711 Borrower/sponsor must be approved by the ORCF Underwriter.
- 712 4. Lender's determination of experience, character and financial capacity of the non-
713 profit Borrower and/or participantsprincipals should include, but is not limited to, the
714 following documentation:
- 715 a. a detailed explanation of the motivation for sponsoring the project including a
716 history of the organization's involvement in multifamily housinghealthcare;
717 b. a copy of the Borrower's charter and bylaws and all amendments;
718 c. a copy of any ruling denying tax exemption;
719 d. a verification from the Internal Revenue Service of the Borrower's tax-exempt
720 status as a 501(c)(3) organization. If a ruling is pending, an explanation of the
721 application's legal status;
722 e. a list of corporate officers or officers of the board of directors of the
723 sponsoring non-profit with decision-making authority (the principals) over the
724 subject property, including their titles or positions, addresses, and individual
725 social security numbers;
- 726 i. resumes for all principals and staff who will actively take part in the
727 development of the proposed project
- 728 ~~ii.~~ current financial statement (balance sheet, profit and loss statement,
729 and supporting schedules) as well as financial statements for the past
730 three (3) years. If available, audited statements should be submitted.
731 Financial statements should conform with the following:
- 732 ~~iii-ii.~~ if the Borrower has existed less than three (3) years, the financial
733 statements must be submitted from the date the group was formed.
- 734 ~~iv-iii.~~ Statements must identify restricted and unrestricted assets (liquidity)
735 along with the related liabilities and must show no material,
736 unmitigated contingent liabilities.
- 737 ~~v-iv.~~ an officer of the sponsoring non-profit must sign the financial
738 statements.
- 739 ~~vi-v.~~ all statements must contain the certification of truth and accuracy and
740 criminal certification identified in Section 6.2.B.1.b above. This
741 certification must reference the name of the sponsor and the date of the
742 financial statements.
- 743 ~~vii-vi.~~ a signed written resolution of the non-profit's directors or trustees,
744 acknowledging the responsibilities and obligations of sponsorship and
745 continuing ownership, and that the subject proposal reflects the will of
746 the membership.
- 747 ~~viii-vii.~~ information contained in Section 6.1.KG if the participant or any
748 officer has a prior federal default or claim.
- 749 f. a detailed statement of the arrangements made or proposed for the following
750 (listing principals involved, their relationship to the non-profit Borrower or
751 other participant, the terms of the arrangements and the circumstances
752 surrounding each):
- 753 i. land on which the project will be built

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

- 800 ii. success and the extent of previous experience, including the type of
801 services furnished (financial, management, etc.), in providing senior
802 housing or related social services.
803 iii. The Borrower is providing or has arranged for the professional and
804 management skills essential to the successful start, development,
805 completion, and operation of the proposed project.
806

807 **B. Credit investigation:** The Lender must determine what individuals and entities have
808 decision-making and operational authority over the project and provide an in-depth written
809 analysis on the aspects of the mortgage credit review in the Lender Narrative. To conduct
810 this credit investigation, the Lender must:

- 811
- 812 1. order data and/or commercial credit reports on the sponsor and ~~Borrower, if~~
813 ~~formed principals~~, and ~~residential/or tri-merge~~ credit reports for ~~the officers of the~~
814 ~~borrower entity individual principals~~ to determine basic acceptability of credit
815 reputation and previous experience. A credit review of individual members of non-
816 profit board of directors is not required unless a member is also a ~~board~~
817 ~~officer principal~~;
 - 818
 - 819 2. check for the existence of any delinquent federal debt;
820
 - 821 3. check that the Borrower and other ~~participants principals~~ have no unresolved issues
822 related to payment history and credit references;
823
 - 824 4. analyze financial data to determine:
 - 825 a. the amount of cash and liquid assets available for investment in the project
 - 826 b. whether the non-profit entity has used prudent judgment in its past and present
827 business affairs;
 - 828 c. overall financial condition of the non-profit entity, particularly whether the
829 financial statements indicate that income will be sufficient to meet the
830 expenses incurred by the group and
 - 831 d. check for the presence of multiple fund accounts, such as general funds and
832 building funds that are commonly maintained by many large non-profit
833 organizations. The Lender should be aware of interfund receivables and
834 payables that cancel each other and must not consider restricted-use funds in
835 the analysis. The Lender should review the public records section of the
836 credit report to eliminate assets that were used as collateral for secured
837 borrowings.
 - 838
 - 839 5. Carefully review the ability of the sponsoring organization to undertake a project of
840 the size and complexity of the proposed project.
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 - 842 ~~6. Review the developer's fee. Non profits may earn a developer's fee on a new~~
843 ~~construction or substantial rehabilitation proposal.~~
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Note: The HUD Underwriter may check with applicable ORCF Account Executives or Multifamily Asset Management offices in the jurisdiction that the non-profit has done or now does business in order to ascertain the past experience and performance of the non-profit.

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

1. the HUD closing attorney determines that there is no legal impediment that would prohibit approval of the request;
2. the non-profit agrees to comply with the terms and conditions of the ~~non-profit~~ regulatory agreement applicable to a profit-motivated entity;
3. the non-profit is subject to the mortgage limitations applicable to a profit-motivated entity;
4. a working capital deposit is required (not applicable to Section 232 refinance projects);
- ~~5. a non-profit developer's fee is not paid with the proceeds of the FHA-insured mortgage loan;~~
- ~~6.~~5. if the non-profit provides evidence that it has obtained exemption from real estate taxes, the tax exemption must run with the real estate and not with the type of sponsorship;
- ~~7.~~6. the potential tax consequences, as well as the possible effect on the non-profit's Section 501(c)(3) status with the IRS is determined to be acceptable;
- ~~8.~~7. the 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.