BedfordLending

HUD Financial Statement & Mortgage Credit Requirements

Borrower Entity

A single asset Borrower entity is required for all multifamily HUD projects. The single asset Borrower entity must be registered in the United States and in the State where its corporate office is located. Natural Persons, Delaware Statutory Trusts, Maryland Business Trusts, foreign entities, and Tenants in Common are not eligible single asset Borrower entities, although such entities may have ownership interests in the single asset entity Borrower. Acceptable forms of single asset entities that may participate include the following:

1. General Partnership (GP); An ownership structure may have two or more general partners. A written partnership agreement may be accepted in lieu of a state registration.
2. Limited Partnership (LP); A limited partnership must have at least one GP and at least one LP and must also conform to the laws of the jurisdiction in which it was established.
3. Corporation, C Corporation, or S Corporation with shareholder owners and corporate officers and directors who may or may not be shareholders.
4. Limited Liability Company (LLC) composed of members, with one or more managing members and one or more investor members.
5. Trust with beneficiaries and one or more trustees (when the Borrower is a trust, the duration of the trust must be equal to or longer than the term on the FHA Note).
6. Nonprofit Corporation with officers and directors.
7. Any other public or private single asset Borrower entity.

Any combination of acceptable ownership forms can be used to establish a joint venture for the purpose of jointly sharing the risks and the rewards and contributing the appropriate knowledge, skills or assets necessary to a successfully developed project. However, the Borrower must always be a single asset entity.

Principals

HUD's term for principals subject to mortgage credit review is "Active Principals".

An Active Principal is any entity that has an ownership interest of 25% or more in the project to be insured, which is reduced to 10% or more for corporations. However, and regardless of the percentage of ownership interest, principals are subject to full credit review if they possess a substantial financial interest or have decision making authority in the Borrower. A substantial financial interest is an interest that would create an ability by the investor to direct the operations of the Borrower, or influence, either directly or indirectly, the decision-making authority of the managing member or general partner and those member(s) of business entities which, if they suffered material negative financial or legal problems, would pose a risk to HUD.

All individual (warm body) "Active Principals" must provide:

- A personal financial statement using the HUD-92417 form or equivalent. The personal financial statement can be no greater than 90 days old at time of loan submission to HUD and spouses, as applicable, must also sign the form.
- Resume
- Credit authorization (we will request authorization and pull credit within 60 days of the HUD application). Although HUD does not establish minimum FICO or liquidity requirements, borrowers who are thinly capitalized or have poor credit are unlikely to be eligible to act as Active Principals.
- Previous participation review using the HUD-2530 form (we will provide). This form requires each principal to briefly describe any prior HUD/federal projects they were involved in.
- HUD-92013 Supplemental form (we will provide). This form requires disclosure of any current, pending, or prior litigation.

If an individual will be signing the HUD regulatory agreement at closing, that individual must also provide:

- Verification of funds available to close. Other principals may be required to provide supplemental verification of funds information (even if not signing the regulatory agreement) to prove that collectively money is available to close..
- Real Estate Owned schedule detailing mortgages they are involved in and their respective ownership position (we will provide a template). The mortgages and associated balances listed will be cross-referenced with applicable financial statements to ensure all figures are accurate. Properties listed in the Real Estate Owned schedule that will mature within five years should reference a plan to refinance or otherwise satisfy that specific indebtedness item.
- "Other Business Concerns" (we will provide a template).

All entity "Active Principals" must provide:

- An audited (or CPA / IPA "Reviewed", if the former are unavailable) most recent full year financial statement and owner certified YTD statement, the latter, as applicable. The statements should include a balance sheet, income and expense statement, and supporting schedules (accounts receivable, etc.)
    - If the LLC or other similar entity is essentially a shell entity and/or is newly formed with no credit history, its warm body members may be used to establish financial capacity, however HUD has the right to request additional information at their discretion.
- Resume
- Organizational documents:

  Organizational Documents include the following:
  - Corporation - Articles of Incorporation & Bylaws; Authorizing Resolution.
  - Partnership - Certificate of Partnership & Limited Partnership Agreement; Authorizing Resolution.
  - LLC - Articles of Organization & Operating Agreement; Authorizing Resolution.
  - Trust Documents. All Document Amendments are required.
- Credit authorization (we will request authorization and pull credit within 60 days of the HUD application).
- Previous participation review using the HUD-2530 form (we will provide).
- HUD-92013 Supplemental form (we will provide).

If an entity will be signing the HUD regulatory agreement at closing, that entity must also provide:

- Verification of funds available to close.
- Real Estate Owned schedule.
- "Other Business Concerns".

Principal Types Not Subject to Credit Review:

1. Investor entities with limited liability benefiting from tax credits, including but not limited to low income housing tax credits pursuant to Section 42 of Title 26 of the United States Code, whether such investors are syndicators, direct investors or investors in such syndicators and/or investors.
2. Parties whose sole interest is that of a purchaser or owner of less than five individual unit(s) in the same condominium or cooperative development; (ii) parties whose sole interest is that of a tenant in not more than two units in an FHA mortgaged insured property.
3. Public Housing Agencies (PHAs) where the PHA is acting in its capacity as a PHA owning and/or operating public housing. However, PHAs are expected to form single asset entities to hold properties financed with FHA mortgage insurance.
4. "Passive Principals" are persons or entities who singly or with others have limited or no decision making power or control over the Borrower but who have an ownership interest of 25% or more (10% for corporations) in the Borrower. Language in the Partnership Agreement or Organizational Documents should evidence that the Passive Principal has no operational or decision-making authority.
    a. A passive Principal's financial or other obligations to the Borrower and the property must be fixed and defined before endorsement, with the Borrower or its Principals having limited or no power to compel a passive Principal to increase its obligations. A passive Principal may have limited power singly or with others, or no power to remove, replace or diminish the powers, or alter the compensation of Principals. As used here "limited" means that the rights of a passive Principal to exert control or effect decisions that are defined in organizational documents and are limited to specific actions intended to remedy negligence or default by a Principal, or to protect the passive Principal from loss due to a default or failure of performance by the Borrower.
    b. Minority partners who are both "Passive Principals" *and* have less than 25% interest in the mortgagor entity as an individual (or 10% for corporations) do not need to be identified.
5. Shell Entities that do not take actions themselves but only serve as legal vehicles through which the partners, members or owners of such entity take actions.
6. Nonprofit Principals are understood to mean "the Single Asset Entity (SAE) Borrower and its Board of Directors" (BODs). The BODs acting as officers and/or member/directors who do not exercise control over the corporation in another capacity are excluded from filing.
    a. Nonprofit entities and sponsoring parent organizations that are Principals with control and exercise day-to-day financial or operational control of the SAE must demonstrate financial strength, credit history, experience and capacity.
    b. Executive officers must provide resumes evidencing experience commensurate with the requirements of the project. Generally, analysis of personal financial information, including credit reports, form HUD-92013-SUPP, and financial statements including verifications of deposit or available liquidity are not required of board members or officers of the nonprofit. Any Officers that exert management control and other executive management including the Executive Director of the nonprofit corporation will provide only the previous participation certification via the HUD-2530 form.

Organizational Chart Requirements

HUD will require an organizational chart of the ownership (mortgagor) entity that includes the following:

1. Depicts all tiers of the ownership structure, starting with the single asset Borrower entity and concluding with the ultimate source of equity. Ultimate sources of equity are often an individual, trust, or a widely held corporation.
2. Displays all intermediate entities such as pass-through entities, which results in a full disclosure of all participants. Controlling and limited ownerships are depicted as separate intermediate individuals/entities.
3. Displays each entity's legal name, type (e.g. LLC or LP) and ownership percentage of its parent. Ownership percentages reconcile to 100% for entities (including intermediate entities).
4. Lists at least one natural person. Tax credit investors and limited investors need not always trace to a natural person.
5. Denotes individuals or entities that will sign Section 50 of the HUD regulatory agreement (i.e. using an asterisk and footnote or other means).
6. Discloses if any entity is publicly held, its exchange, and ticker symbol (e.g. "XYZ Corp. (NYSE: XYZ)").
7. Consolidates or groups widely held interests to achieve conciseness. For example, a group may be labeled on the organizational chart (e.g. "10 Additional Limited Partners"), along with aggregate ownership percentage.
8. Provides additional disclosure in narrative form or a separate organizational chart, avoiding unnecessary visual complexity of the Borrower's organizational chart.

Financial Statements

For new construction projects, operating expenses must be estimated on the basis of comparable properties.

For existing projects (including substantial rehabilitation projects), both for appraisal purposes and underwriting, the borrower entity must submit:

- The last three fiscal years of financial statements on the project.
- If more than three months have elapsed since the closing date of the most recent fiscal year, a year-to-date balance sheet and operating statement.
- If three years have not elapsed from certificate of occupancy to application submission, any full year statements must be provided as well as a year-to-date balance sheet and operating statement.
- A trailing 12 month profit and loss statement.

Please note:

- The last fiscal year **and** any year to date (interim) period greater than six months must be audited or CPA or IPA "Reviewed". "Reviewed" is a defined term in the accounting space. This does not apply to the trailing 12 month statement which can be provided by the borrower. Year to date (interim) statements of less than six months are subject to CPA or IPA Review if the transaction has higher risk factors. If a project has low risk factors (very stable trendline over the past three years) an owner certified year to date statement may be accepted on a case-by-case basis.

- Owner certified financial statements may be submitted for the years prior to the last full fiscal year. The owner certification must include the following verbiage:

"WARNING: 18 U.S.C. 1001 provides, among other things, that whoever knowingly and willingly makes or uses a document or writing containing any false, fictitious, or fraudulent statement or entry, in any matter within jurisdiction of any department or agency of the United States, shall be fined under that title or imprisoned for not more than five years, or both."

- Newly built / rehabilitated projects that have received a certificate of occupancy less than three years prior to application must provide as much historical information as feasible and are subject to the same conditions noted above.
- For existing assets that have been in operation for more than three years, but do not have three years of financial statements (due to a prior ownership's bankruptcy, distressed purchase, etc.) the borrower must submit a statement that explains why the required records cannot be obtained and certify this statement with the above verbiage.