



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

---

Special Attention of  
All Multifamily Hub Directors  
All Program Center Directors  
All Project Managers  
All Field Office Directors

Notice H 2013-07

Issued: March 8, 2013

Expires: This Notice remains in effect until amended, superseded, or rescinded.

---

Cross References:  
Mortgagee Letter 2010-21  
Housing Notice 2010-11  
Housing Notice 2010-13

---

SUBJECT: Concentration of Principal Risk; Principals with Insured Assets Greater than \$250 Million.

**I. PURPOSE**

**A. Previously Issued Risk Mitigation Guidance**

On July 6, 2010, HUD issued Mortgagee Letter (ML) 2010-21 and Notice H 2010-11 concerning measures to mitigate risks on FHA mortgage insurance for multifamily properties. Paragraph III.A.5 of Mortgagee Letter 2010-21 stated:

*Particular attention and additional scrutiny will be given in cases where principals have greater than \$250,000,000 of outstanding FHA insured debt. Based on their review of the principals' Schedule of Real Estate owned, the lenders must identify principals that exceed this \$250,000,000 threshold. Lenders will need HUD pre-approval before such principals or Borrowers may apply for additional insurance commitments; further guidance will be issued separately to address the process for obtaining HUD approval.*

For purposes of performing the creditworthiness review discussed in this Notice, principals are those individuals or entities that have significant financial interest and/or management decision making authority such that their financial or credit problems could destabilize the properties considered for mortgage insurance.

This Notice clarifies guidance and processing procedures describing how lenders can obtain prior approval in order to receive FHA's consideration for additional mortgage insurance commitments when the principals will have total insurance in place, including the proposed additional commitments, equal to or in excess of

\$250,000,000. In addition, other principals with 25 or more commercial real estate assets, but with insured loan balances that total less than \$250,000,000, have the option to obtain HUD credit review prior to submitting project applications.

## **B. Applicability**

This Notice applies to all applications for FHA multifamily insurance programs, except for refinancing pursuant to Section 223(a)(7) of the National Housing Act. It does not apply to programs administered by the Office of Healthcare. However, in determining whether a principal meets the threshold of insured loans totaling \$250,000,000 or more, lenders must include all FHA insured loans in the total, including Healthcare loans, but excluding any state or local Housing Finance agency or GSE Risk Sharing loans.

## **C. Purpose of Prior Approval**

The purpose of HUD prior approval of principal creditworthiness is:

1. To determine whether a principal represents a reasonable credit risk given the operating performance, age, utility and physical condition of the principal's existing FHA insured and other properties;
2. To determine the amount of any new mortgage insurance commitments that may be extended to a principal given their credit history, cash flow, net worth, liquidity, scheduled debt maturities and operational stability;
3. To identify and evaluate risks arising from any unique combination of assets that may suggest an adverse circumstance that could impact the stability of the principal's portfolio, such as concentration in a particular asset type, industry sector or geographic or market concentration;
4. To assure a consistent, timely and efficient response to principals with portfolio holdings which may be scattered among numerous Multifamily Hubs; and
5. To enable the largest users of FHA programs to plan for future property development or acquisition relying on financing available through the insurance programs.

## **II. SCOPE OF PRIOR CREDIT REVIEW AND APPROVAL**

### **A. Mandatory Prior Approval**

Lenders must not submit pre-applications or applications for mortgage insurance for principals, whose insured debt balances, including any new proposed insurance commitments, equal or exceed \$250,000,000 without first obtaining HUD approval. When applying the \$250,000,000 threshold to a principal's insured loan balances, the lender shall exclude any state or local housing finance agency or GSE risk sharing loans, and shall not adjust insured loan balances to account for a principal's fractional ownership interests. It is the lender's responsibility to determine whether a principal to a proposed transaction(s) has or will have insured principal balances exceeding the threshold. This requirement for prior approval will not be waived.

## **B. Voluntary Prior Approval**

Prior to filing an application for a specific project, the lender may request prior credit review and approval for any principal with 25 or more commercial real estate assets (whether or not FHA insured) notwithstanding aggregate loan balances or values. Accordingly, any applicant with 25 or more multifamily or commercial real estate assets who anticipates filing multiple applications for insured financing within a 12 month period may obtain prior credit review and approval of principals' creditworthiness in a single request, eliminating the reviews of principals' mortgage credit otherwise required with each separate project application.

## **C. Review of Requests**

The lender's request for prior approval will be reviewed and approved by the Technical Support Division of the Office of Multifamily Housing Development.

## **D. Scope of Review**

The lender must conduct a complete mortgage credit review of principals subject to this policy and prepare an analysis of the sponsors' creditworthiness, including a review of all observed risks and prospective mitigants together with a recommendation for credit approval. Requests for prior approval must analyze the performance and the risk profile of the existing portfolio together with the financial strength, credit history and experience of the principal(s). The request must identify all known or expected new insurance applications as well as other, anticipated uninsured commercial real estate transactions. The review must describe any material changes in the principals' financial position expected during the 12 months following the date of the credit submission as well as any additional periods of time required for the stabilization of new developments or troubled assets. An essential element of the review is an assessment of the sponsors' ability to meet reasonably anticipated financial and management demands during the period when applications are under consideration and continuing through stabilization. While the \$250,000,000 threshold for requiring prior approval applies only to insured assets (excluding any state or local housing finance agency or GSE risk sharing loans), the scope of review includes all real estate owned and/or proposed for development or acquisition, with or without mortgage insurance.

HUD consideration of requests for prior approval does not relieve the lender of the responsibility to submit a properly underwritten MAP application for each project proposed for insured financing, nor does such consideration obligate any Hub to reach a conclusion on the merits of any particular project application other than the creditworthiness of the Principals which already will have been reviewed and approved.

## **E. Terms and Duration of Prior Approval**

The Technical Support Division will notify Hub Directors of its determination of the principal's creditworthiness and will specify a date when the credit approval expires. Depending on the applicant's financial strength and credit history, the Director of Technical Support will approve the request, approve with conditions, or disapprove the request. When appropriate to specific circumstances the Director of Technical Support may condition an approval with bounds including, but not limited to, one or more of the following:

1. A list of particular named projects for which new insurance applications may be submitted;
2. Certain types of projects (e.g., refinance, but not new construction) or to specific markets or particular geography;
3. A maximum amount of new insurance commitments for which the principal may apply;
4. A maximum liquidity amount that may be required by new insurance commitments, or a minimum liquidity amount that the sponsor must maintain: or
5. Requirements for specific measures or remedies to address identified credit issues.

The principal's continued credit worthiness will be confirmed during processing of each new Firm Commitment application, but normally, and absent material changes in the principal's financial condition, the prior approval will be effective and may be relied upon for 12 months from the date of the credit approval.

### **III. PROCESS FOR PRIOR CREDIT REVIEW AND APPROVAL**

#### **A. Method of Submission**

Requests for prior approval may contemplate multiple project applications in varying locations over a period of time. The following steps are required for submission:

1. Designation of lender, lead lender. The sponsor must select a MAP lender to prepare and underwrite its request for prior approval. If the sponsor has or proposes to have individual project applications prepared by more than one MAP lender, then the MAP lender preparing the request for prior approval shall be the lead lender. The sponsor must disclose the identity of the lead lender to each of the other lenders and must authorize and direct the lead lender to share with any other lenders its request for prior approval and any HUD response to such requests.
2. Form of submission. The lender shall provide an original (with original signatures), a hard copy and a reproducible electronic version of the request for prior approval.

3. Where to submit request. The lender shall submit the request for prior approval to the Director of the Multifamily Hub with jurisdiction for the initial project application contemplated after prior approval is obtained.
4. Hub administrative action. The Multifamily Hub receiving the lender's request for prior approval shall retain the original and forward the hard copy and the reproducible electronic version of the request to the Director, Technical Support Division of the Office of Multifamily Housing Development. The Director of Technical Support will copy the Hub on all correspondence arising from the request for prior approval. The Multifamily Hub must retain the original of the lender's submission together with all relevant correspondence with the docket for the first project application it receives pursuant to any prior approval, and if there is no approval, then the submission must be retained consistent with the Hub's practice for rejected project applications. The Technical Support Division will retain the electronic version at headquarters.

## **B. Information Required From the Lender**

The lender's request for prior approval must contain the following information concerning the principal(s) and their portfolio:

1. A description of the sponsor, individual(s) and/or entity(ies) and their role(s) including:
  - a. The name, address and contact information for each principal.
  - b. An organizational chart and narrative description defining the business structure, roles and relationships of the principals.
  - c. A resume for each principal and a brief history of the joint business activities of the principals.
2. A mortgage credit review for each principal and for the sponsor group of controlling entities, addressing the principals' financial strength, net worth, liquidity and credit history. In conducting the mortgage credit review, lenders shall exercise reasonable judgment when identifying principals in complex organizations, limiting inquiry and required personal disclosures to persons and entities that exercise active control and bear the risks and/or accountability of ownership, clearly referencing the organization chart and description of business structure described in paragraph III.B.1 above. Where financial statements for mortgagor or operating entities are audited, consolidated financial statements for the organization are acceptable. The review must explain and mitigate any negative personal or business credit information and be consistent with the MAP Guide, Chapter 8, as applied to active principals only. Credit review for general contractors and passive or limited partners generally should be completed concurrent with applications for individual projects. Similarly, review of previous participation through the APPS-2530 process will be completed for principals

with each individual project application by the HUD office reviewing the project application.

3. A Schedule of Real Estate Owned and Existing Debt for the principal, which must include properties with insured debt as well as for non-FHA properties in spreadsheet format permitting data sorting both for individual properties and for properties in the aggregate by particular characteristics (e.g. debt service coverage, loan to value, occupancy, debt maturities, year built, project location, etc.).
4. FHA insured assets listed in the REO schedule shall be described in detail as to current physical condition, inspection history [including REAC scores], escrow balances, current occupancy and debt service coverage. For any troubled assets, the lender must describe and evaluate the principals' responsibility, if any, for problems, as well as the nature and effectiveness of any remedies attempted.
5. Non HUD-FHA assets shall be reviewed with particular attention given to pending debt maturities and to properties with debt service coverage ratios less than 1.1 to 1 or otherwise identified as stressed. The lender must ascertain and review the principal's response to any problem properties.
6. In any instance where non-residential assets represent a material component of the principal's real estate owned, the principal must provide, or the lender must supply or retain, underwriting expertise qualified to evaluate the issues and risks associated with the asset type(s).
7. A description of all properties that are proposed for FHA insurance with an estimate of the cash requirements for closing each transaction and indicating whether the properties proposed for insurance are already held in the principal's portfolio, the purpose of the anticipated financing (refinance, rehabilitation, new construction) and the rationale and criteria used for selection of the proposed new insured properties (e.g. potential for cash flow or physical improvement, asset type, size, target market, geography, etc.). Generally, proposed projects should be specifically named and identified by address, but where acquisition, development or refinancing targets are to be determined, tentative or contingent, projects may be described generically.
8. A financing plan displaying the liquidity and cash flow of the principals and business entities in relation to the estimated cash requirements for the projects proposed for insurance as well as for the projected calendar of capital transactions for other real estate owned. The period covered by the financing plan must be not less than the 12 months following the anticipated prior approval and shall also include any anticipated additional period required to achieve stabilization for any new development or troubled asset.

9. A description of the provisions made by the principals to assure continuity and orderly succession in leadership and/or orderly disposition of assets in the event of any incapacity of the principal. This description must include a brief summary of partner buy/sell agreements, provisions for key person insurance and/or similar measures sufficient to evidence careful planning for these contingencies. Descriptions of prior changes in leadership, if any, should be provided if they document how the principal would deal with future changes.
10. When a principal is a corporation whose shares are publicly traded and subject to the regulation of the Securities and Exchange Commission, the lender may accept annual Form 10-K filings and quarterly earnings statements as financial statements and when available the lender must provide the credit rating of securities rating agencies such as Standard and Poors, Moody's and Fitch. Personal financial disclosure by officers and directors is not required. Verification of deposits is not required.
11. A determination that the principal or any mortgagor controlled by the principal is not a defendant in any outstanding lawsuits brought by the Federal Government, has no outstanding delinquent debts owed to the Federal Government and does not have any outstanding civil rights lawsuits brought by the Department of Justice [DOJ], charges initiated by HUD's Office of Fair Housing and Equal Opportunity [FHEO], or administrative actions or lawsuits brought by substantially equivalent state or local Fair Housing agencies, that have not been resolved to the satisfaction of DOJ, HUD, or the respective state or local Fair Housing agency at the time of the request for prior approval.

### **C. Lender's Analysis and Recommendation**

The lender will analyze the stability of portfolio ownership and management structure, portfolio characteristics and market conditions and recommend prior approval of a principal's creditworthiness. The analysis shall include:

1. Review of the stability of ownership and management.
2. Evaluation of any problems and challenges confronting the principal and the principal's plans for action in response to such challenges including:
  - a. Underperforming properties, (e.g., properties at less than 90% occupancy; properties at less than 1.1 to 1 debt service coverage; properties with significant physical or management problems).
  - b. Existing defaults and/or pending capital transactions, (e.g., anticipated refinancing or refunding, pending balloon payments, interest rate resets).
  - c. Property or Asset Management deficiencies, (e.g., underfunded reserves, deferred management fees).
  - d. Suits, judgments, liens or related adverse actions.

- e. Weak or unstable markets affecting geographically concentrated properties or other actual or prospective adverse conditions affecting a unique combination of assets and the impact of such conditions on the portfolio.
3. The lenders analysis and evaluation of the principals' plan or criteria for selecting additions to the portfolio and/or additional FHA insured assets with a conclusion as to whether and how the proposed plan or criteria will strengthen the portfolio.
4. A specific conclusion as to the underwritten net worth, current liquidity and cash flow of the principal(s) and the business organization and whether financial resources are adequate to meet anticipated needs during the year following the request for prior approval and any additional period required to stabilize new developments or troubled assets.
5. A determination whether the principal's reputation, past performance and capacity support a conclusion that insured assets will be maintained in good physical condition, with timely capital replacements and prompt, effective action to remedy problems.

#### **D. Action by the Technical Support Division**

Upon receipt of the request for prior approval, the Technical Support Division will review the submission and within 30 days issue a decision that will:

1. Explain the reasons for the decision, identifying areas or issues of strength and/or weakness;
2. Define the terms and conditions, if any, which may attach to the decision;
3. If adverse, define remedies or conditions which would allow reconsideration;
4. Quantify the net worth and liquidity available to the principal(s) in light of analysis of the principal's existing business operations and pending transactions.
5. Identify specific projects proposed for insurance (or alternatively, when specific projects are yet to be determined, the location(s) and kinds of insured transactions, e.g. refinancing, new construction, etc) which are given prior approval and the estimated aggregate sum of the principal's cash or other liquid assets required to close these transactions.
6. Identify steps, if any, that Hub/Program Centers and lenders must take to coordinate completion of the proposed schedule of applications and resulting commitments and closings.
7. Describe the process to be followed by the lender in the event of any appeal of the decision on the request for prior approval.

The Director of the Technical Support Division will send the written decision to the lender and to the originating Multifamily Hub as well as to each Multifamily Hub/Program Center with jurisdiction for any of the named projects proposed for insurance. In addition, the decision will be made available to all other Multifamily Hubs at the HUD Multifamily SharePoint site at

<http://hudsharepoint.hud.gov/sites/DASMFH/OMHD/CRD/default.aspx>.



## **E. Project Applications After Prior Approval**

Upon receipt of the prior approval, the lender(s) may file applications with the relevant Hub/Program Center for projects consistent with HUD's decision on the request. For each application, the mortgage credit exhibits shall include:

1. A copy of the prior approval decision.
2. Original, written certification(s) signed by each principal who is a subject of the prior approval decision stating that no material changes have occurred in the circumstances of the principal or the portfolio as described in the request for prior approval except as are fully described. The sponsor must disclose any and all loan applications filed, commitments issued, and transactions closed as well as loan delinquencies, modifications, settlements or forbearance agreements concluded or any other change bearing on its ability to execute the transactions for which prior approval was requested. In the event that material changes have occurred, the principal shall also certify to the accuracy and completeness of the description of the material changes. The certification must contain the following language: "HUD will prosecute false claims and statements. Convictions may result in criminal and/or civil penalties. (18 U.S.C. 1001, 1010, 1012, 31 U.S.C. 3729, 3802)".
3. The lender's updated review and analysis of the creditworthiness of the principals in light of any materially changed circumstances. This review must consider all changed circumstances and describe how and why the lender concluded the changes were or were not material.
4. The lender's updated or adjusted financing plan showing the sponsors available liquidity and how the sponsor's resources have been or will be used to meet cash requirements arising from existing or proposed assets in accordance with HUD's prior approval decision.
5. In the event of a material change arising only from changes in the capital requirements of pending transactions, and not from altered and adverse performance of assets or the creditworthiness or behavior of the principal(s), then the lender may reallocate the principal's available resources to meet the cash requirements for particular projects, provided that the aggregate cash requirements do not exceed limits described in the prior approval. Any such reallocations must be documented in the updated financing plan. Such adjustments may result in the deletion of a project(s) proposed for financing and given prior approval, but additional or substitute transactions are not permitted unless additions or substitutions are authorized in the prior approval decision.
6. In the event that material changes arise from altered and adverse performance of existing assets, adverse credit behavior of the principal(s) or adverse events arising from sponsors' acts (or inaction), or failure to meet terms and conditions

of the prior approval decision, then the Hub/Program Center shall refer the description of the material changes, the lender's updated review and updated financing plan to the Director, Technical Support Division. The Division of Technical Support will:

- a. Confirm or amend the prior approval decision in light of the material changes and allow the subject application and/or further applications, to proceed in accord with the confirmed or amended prior approval, or
- b. Terminate the prior approval, in which event, the subject application and any further applications for mortgage insurance will require a new request for prior approval.

The Director of the Technical Support Division will send the lender and/or the lead lender and the Hub/Program Center(s) written notice of any confirmed, amended or terminated prior approval decision and any such notice will also be posted to the HUD Multifamily SharePoint site at

<http://hudsharepoint.hud.gov/sites/DASMFH/OMHD/CRD/default.aspx>

In the event that the prior approval decision is terminated due to the behavior of the principal(s) and such behavior gives rise to an enforcement action, no new request for prior approval will be accepted until such enforcement action is resolved. Enforcement actions are outside the scope of this Housing Notice.

#### **F. No Change to Loan Committee Review of Project Applications**

Prior approval of principals does not alter existing guidance establishing thresholds for required Hub or National Loan Committee review and approval of insurance applications for specific projects.

#### **G. Costs of Prior Approval Are Mortgageable**

The lender may charge a reasonable fee for preparing the principal's prior approval package for submission to HUD. Subject to existing MAP limits on lender fees and charges on individual loan applications, the fee charged by the lender for preparing a request for prior approval, together with any third-party costs incurred, are mortgageable and may be allocated or prorated among one or more of the projects submitted for new insurance commitments at the discretion of and subject to the mutual agreement of the applicant and the lender(s).

#### **H. Process for Lender Appeals of Prior Approval Decisions**

If a lender, (the lead lender when multiple lenders are engaged) disagrees with HUD's determination with respect to a prior approval decision, the lender may appeal. Any such appeal must be filed within 30 days of the date of HUD's written decision on the

prior approval request and must be documented with an electronic, a hard original and one hard copy of the appeal.

1. The appeal should be filed with the same Multifamily Hub to which the original request for prior approval was submitted. The Multifamily Hub will retain the original appeal with the docket file and forward the electronic and hard copies to the Director, Office of Multifamily Housing Development.
2. The lender's appeal shall:
  - a. Cite the specific cause or issue which is the occasion of the appeal.
  - b. State the specific change requested in the decision of the Technical Support Division.
  - c. Cite any published guidance, standard industry underwriting practice, or evidence of error which supports the change.
  - d. Provide any other new or additional evidence not previously presented to HUD.
3. The Director of Multifamily Development must review the appeal and within 15 business days after receipt by HUD of the lender's appeal (30 days if the lender's appeal offers new or additional evidence not previously presented), the Director will prepare and send a written decision to the lender, with a copy to the Hub Director.
4. When conducting the review of the appeal, the Director of Multifamily Development must ensure a wholly independent review and, except for ascertaining matters of fact, rely only on staff with no prior engagement or participation in the initial decision on the request for prior approval.
5. The decision of the Director of Multifamily Development on the appeal shall be dispositive and shall detail in writing the substance of and the reasons for any denial of the appeal or revision of any earlier decisions and will be posted to the same HUD Multifamily SharePoint site as original prior approval decisions.
6. The Multifamily Hub will retain the original of the appeal submission and related materials. If a lender's appeal is approved, then the Hub will retain the original materials with the docket for the initial project application received pursuant to the prior approval. If denied, the submission must be retained consistent with the Hub's practice for rejected project applications. The Office of Multifamily Development will retain the electronic version at headquarters.

#### **IV. IMPLEMENTATION**

This Housing Notice is effective immediately.

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0029. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

If there are any questions, and/or concerns regarding this Housing Notice please contact David Wilderman at (202) 402-2803, in HUD Headquarters, Office of Multifamily Housing Development. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

---

Carol J. Galante  
Assistant Secretary for Housing – Federal  
Housing Commissioner

