

U.S. Department of Housing and Urban Development
HOUSING

Special Attention of:

All Multifamily Hub Directors
All Multifamily Program Center Directors
All Operations Directors
All MAP Coordinators
All MAP Team Leaders
Mortgage Credit Examiners; Valuation Appraisers
Project Managers

Notice H 01-4 (HUD)

Issued: May 30, 2001
Expires: May 31, 2002

Cross References:

MAP Guide
Handbook 4470.1 REV-2
Handbook 4560.1 REV

Subject: Section 221(d)(3) Nonprofit Transactions

I. BACKGROUND

Over the past several weeks, the Office of Multifamily Housing Development in Headquarters has been reviewing field office documentation on a number of Section 221(d)(3) nonprofit transactions. We have found that in many cases the transaction is controlled by a profit motivated entity rather than the nonprofit sponsor. This is in direct conflict with instructions in the Mortgage Credit Handbook 4470.1 REV-2 and the MAP Guide. The instructions require HUD to make a determination that the nonprofit sponsor/mortgagor is acting on its own behalf and is not, either knowingly or unwittingly under the influence, control or direction of any outside party seeking to derive a profit or gain from the proposed project such as a landowner, real estate broker, contractor, architect, attorney or consultant. In these transactions, a profit motivated entity can take advantage of the 100% financing, the nonprofit developer's fee, financing alternatives and tax advantages available to a nonprofit sponsor/mortgagor with limited or no risk by the profit motivated entity. This practice has created a credit subsidy problem for the FHA mortgage insurance programs in Fiscal Year (FY) 2001 because Section 221(d)(3) loans carry a credit subsidy rate of 17.22 percent, over 5 times the Section 221(d)(4) rate of 3.35 percent. Furthermore, it creates additional risk for the General Insurance Fund since the profit motivated entity that controls the entire transaction may well have collected its fees at closing and have little or no concern about the long term financial and physical health of the project.

II. UNDERWRITING PROCEDURES

As a result of our reviews, the following policies are effective immediately for Section 221(d)(3) nonprofit transactions involving either Multifamily Accelerated

Processing (MAP), or Traditional Application Processing (TAP) for which Headquarters has not authorized issuance of an FHA firm commitment.

- A. Hubs/Program Centers must review;
 - 1. The instructions on evaluating a nonprofit sponsor/mortgagor found in Chapter 14 of HUD Handbook 4470.1 REV-2 and Chapter 8 of the MAP Guide. The evaluation of a nonprofit sponsor/mortgagor under the mortgage insurance programs must be comprehensive.
 - 2. The Form 3433, Request for Preliminary Determination of Eligibility as Nonprofit Sponsor/Mortgagor, and backup materials provided at SAMA, Feasibility or MAP preapplication to determine that all of the documentation required by Chapter 8, of the MAP Guide and Chapter 14 of handbook 4470.1 REV-2, is submitted.
- B. The memorandum of findings described in paragraph 14-5 of Handbook 4470.1 REV-2 is required in every case.
 - 1. It must include a description of the relationship between the nonprofit and profit motivated entities involved in the transaction.
 - 2. The determination of eligibility or ineligibility of the nonprofit sponsor/borrower must be signed off personally by the Hub/Program Center Director.
- C. Section 221(d)(3) nonprofit sponsors must disclose in detail with the firm commitment application any proposed or existing contractual arrangements with profit motivated entities involved in the transaction. ***Forms HUD-3434 and HUD-3435 will now be required to be submitted at the firm commitment stage as well as prior to initial closing.***
- D. All Section 221(d)(3) commitments authorized to proceed by Headquarters will be issued conditioned upon submission and HUD approval of the final Forms HUD-3434 and HUD-3435 and supporting documentation. FHA will have the right to terminate the commitment if any question is raised about the relationship between the sponsor or borrower and any other entity involved in the transaction. See item IV.A. below.

- E. *Headquarters will continue to review all Section 221(d)(3) processing before a Hub/Program Center can be authorized to issue a Section 221(d)(3) firm commitment.*
- F. Handbooks 4470.1 REV-2, 4560.1 REV-1 and the MAP Guide are being revised to conform to these procedural changes.

III. CONTINUED HEADQUARTERS REVIEW

To address our concerns about approval of Section 221(d)(3) nonprofits, we will continue to review all Section 221(d)(3) MAP and TAP *firm commitment processing only*. Field Offices must submit to the Office of Multifamily Development, Attention: Felicia Williams, the following documents for review:

- A. Form 3433, Request for Preliminary Determination of Eligibility as Nonprofit Sponsor/mortgagor, and supplemental documentation.
 - 1. Detailed explanation of motivation for sponsoring the project.
 - 2. A copy of the sponsor/mortgagor's charter and bylaws or constitution as currently amended.
 - 3. Copy of a current effective ruling from the Internal Revenue Service on sponsor/mortgagor's tax exempt status.
 - a. Copy of any ruling denying tax exemption.
 - b. If a ruling is pending, explain the application's legal and factual basis and current status.
 - 4. List of officers, directors or trustees of the sponsoring group/mortgagor including addresses and titles of positions and their social security numbers.
 - 5. Resumes on all principals and staff who will actively take part in the development of the proposed project.
 - 6. Current financial statement (balance sheet, profit and loss statement, and supporting schedules) as well as statements for the past 3 years, if available.

7. Signed written resolution of its directors or trustees, acknowledging the responsibilities and obligations of sponsorship and continuing ownership, and that this position reflects the will of the membership.
 8. Form HUD-92013 Supp listing current bank and trade references for the sponsor; mortgagor, if formed and their officers (President, Vice President, Secretary and Treasury).
 9. The information from the sponsor, mortgagor or any officer concerning prior Federal default or claim, if applicable.
 10. Detailed statement of arrangements made or proposed for the following, (listing the principles involved, their relationship with the sponsor/mortgagor, the terms of the arrangements and a description of the circumstances surrounding each):
 - a. Land on which the project will be built.
 - b. Project construction, including selection of general contractor, subcontractors and architect.
 - c. Legal and consulting services.
 - d. Project financing, including any discounts.
- B. Description of who is paying pre-development costs.
- C. Any proposed rent/income restrictions.
- D. Copy of Form FHA-2013, Application for Mortgage Insurance.
- E. Forms HUD-3434, Certificate of Relationships and Nonprofit Motives and HUD-3435, Certificate of Contractual Relationships.
- F. Developers Agreement or any other document which shows the relationship and work responsibilities of all parties associated with the transaction.
- G. Housing Consultant's Contract, if applicable.
- H. Site Control.
- I. Memorandum of Findings & Recommendations.

IV. RESULTS OF THE HEADQUARTERS REVIEW

Upon completion of our review, a field office will receive written notification that a case is:

A. Accepted for Section 221(d)(3) insurance.

The commitment to be issued/reissued to a nonprofit mortgagor must include the following special condition:

"At least 15 days prior to initial endorsement of the note for insurance, the sponsor and mortgagor shall certify to the Commissioner on Form HUD-3434, Certificate of Relationships and Nonprofit Motives, as to their relationship with persons, parties or firms furnishing land and services (architect, general contractor, managing agent, etc.) and such persons, parties or firms furnishing land and services shall certify to the Commissioner on Form HUD-3435, Certificate of Contractual Relationships, as to their relationship with the sponsor and mortgagor. Subsequent to such certifications, if there is a change in the certified relationships, the sponsor/mortgagor and other parties must furnish the Commissioner additional certifications with regard to such change. All relationships are subject to the approval of the Commissioner, and the Commissioner reserves the right to refuse endorsement of the note for insurance if such relationships do not satisfy the requirements in Chapter 14 of Handbook 4470.1 Rev-2, Chapter 8 of the MAP Guide, and this Notice."

B. Rejected for Section 221(d)(3) mortgage insurance.

1. The mortgagee may withdraw the project. Hubs/Program Centers will refund FHA application fees without question where a mortgagee requests a refund because the case was rejected for Section 221(d)(3) mortgage insurance.
2. The case may be reprocessed as Section 221(d)(4) without payment of additional FHA application or commitment fees.
3. If the Sponsor elects to proceed under Section 221(d)(4), the application must be reprocessed using Section 221(d)(4) guidelines, ex., BSPRA/SPRA in lieu of a nonprofit developer's fee.

Sean G. Cassidy
General Deputy Assistant Secretary for
Housing-Deputy Federal Housing
Commissioner