



Mortgage Credit Panel



Active/Passive Principals



Active Principal:

- Responsible for execution of all activities (operational and financial) for the benefit of the project, ***regardless of the extent of ownership interest.***
 - May be individuals or entities
 - May individually or collectively direct and control borrowing entity

Passive Principal:

- Has limited or **NO** decision making power or control.

***The decision of determining active and passive principals is
SUBJECTIVE!***



Consider the following when making the decision:

- Identify how the property is owned; understand all layers of the ownership structure
- Identify the borrower's experience and qualifications to owning, operating, and managing multifamily real estate
- Identify who has decision making authority
- Identify who has financial capability to contribute funds



Be Aware!

- Not all principals are treated the same!
- Ownership percentage is **NOT** the determining factor of whether a principal is classified as active or passive.
- An individual may own less than 25% (partnership, LLC) or 10% (corporation) but still have operational and financial control.
- Identify problem areas early



Separate classification from Previous Participation – each has its own guidelines and they may or may not be the same.



Examples of Operational Control in organizational documents include:

- Develops and approves the annual budget
- Has approval authority for significant expenses, refinance, dissolution
- Is able to hire/fire management agents, etc.
- Appoint staff or decision maker



Active Principals need some level of Mortgage Credit Review:

- Full Mortgage Credit including REO Schedule (Section 50 signers)
- Full Mortgage Credit excluding REO Schedule (active principals not signing Section 50)
- Limited Mortgage Credit (management agents, general contractors, potentially others)



Full Mortgage Credit review for Active Principals NOT signing Section 50

- Some principals may have financial capacity but not full decision making authority
 - For example, an investor who has exceeded the \$250 million threshold or wishes to avoid exceeding the threshold and invests as a passive investor with less than 25% (or 10% for a corporation) will require a limited mortgage credit review.



	Limited Credit Review	Full Credit Review (not Section 50 signer)	Full Credit Review (Section 50 signer)
Credit Release/Report	✓	✓	✓
Resume	✓	✓	✓
Financial Statements	✓	✓	✓
HUD 2530 (depends)	✓	✓	✓
HUD 92013 SUPP	✓	✓	✓
OFAC/LDP/SAM	✓	✓	✓
Internet Search	✓	✓	✓
Other Business Concerns		✓	✓
VOD/Bank Statement			✓
REO Schedule			✓



Examples of Others requiring a LIMITED Mortgage Credit Review

Management Agents with Identity of Interest (IOI)

- HUD 92013 SUPP; answer 4 questions, can check credit reports for trade references
- Resume
- HUD 2530
- Financial Statements
- Credit Reports
- Internet search

Management Agents with no Identity of Interest

- Waiver of credit reports
- HUD 92013 SUPP; answer 4 questions, can check credit reports for trade references
- Resume
- HUD 2530
- Internet search

General Contractors

- Resume
- Financial Statements
- VOD
- HUD 92013 SUPP; answer 4 questions, can check credit reports for trade references
- HUD 2530
- Credit Reports
- Internet search



Passive Principals Are Not subject to Credit Review!!

Passive principals have no decision making authority or financial capacity

BUT, if a passive principal is providing the initial project cash investment (with no ongoing obligation to support the project), the availability of cash must be verified.

Bottom Line: Every case will be different. The MAP underwriter must complete research on the borrower to determine who qualifies as principal and the level of mortgage credit required.



Underwriting Notes:

1. Be careful of structures or layered organizational structures
2. Identify the individuals and entities with operational control (decision makers)
3. Identify the individual and entities with financial capacity
4. Identify anyone who owns a substantial interest in the property, what is their role?
5. Conduct Previous Participation analysis separately
6. Be cautious when identifying passive principals: are they really passive, especially if they own a significant percentage? Is it clear the individual or entity has no say in the project? Are they bringing cash to close?
7. The determination of the principals is subjective; but be able to support the decision.
8. Ask questions to clarify the roles.



Previous Participation

- **New term “specified capacity” – Specific roles include:**
 - Borrower/owner
 - Management Agent
 - General Contractor



- **Controlling Participants include:**

- Specified capacities
- Individuals and entities who have operational or financial control of the specified capacities
- Must have at least 1 natural person
- Ownership percentage is taken into consideration
- Refer to Processing Guide to determine who qualifies



Individuals/Entities Considered Controlling Participants

1. Entities/individuals owning, directly or indirectly 25% or more of the specified capacity
2. Controlling owners of entities that control specified capacity, including individuals and entities who own 25% or more of the specified capacity
3. Any officer (or equivalent, executive management) of specified capacity or controlling participant, directly responsible to the board and have the ability to prevent or resolve violations or circumstances giving rise to flags
4. Manager or managing members of LLC
5. General partners of limited partnership
6. Partners in a general partnership
7. Executive director or equivalent role of non-profit



8. Members of for-profit corporations Board of Directors who are also officers of corporation
9. Controlling stockholder of corporation for those owning at least 25% or more of controlling interest
10. Trustees of a Trust
11. For REITS, the REIT itself; CEO and all company officers (except those with no day-to-day control)
12. Individual or entity who will sign Section 50 of the Regulatory Agreement
13. Any other person or entity determined by HUD to exercise day-to-day control, financial or operational over a specified capacity.



Entities NOT Considered Controlling Participants

- Wholly owned entities – owned 100% by 1 individual or entity
- Shell entities – don't take actions themselves, only serve as legal vehicles for partners/members or owners to take action
- Tax credit investors – LLCI certification
- Passive participants with no control
- Minor officers of corporation – “significant involvement” means an ability to prevent or resolve violating or circumstances giving rise to flags related to the covered project.



Entities NOT considered Controlling Participants (cont.)

- Members, partners, stakeholders and owners of entities with less than 25% share with no control through another capacity – specifically addresses that Identity of Interest percentages must all be considered when determining 25%. Familial relation or common financial interest should be considered to determine if effective ownership interest
- Members of Board of Directors, non-profit or for-profit who do not exercise control through another capacity (Executive Director or Officers)



Entities NOT considered Controlling Participants (cont.)

- Individual shareholders of a publicly held company and the company itself do not file. The CEO, controlling shareholder and any other individual identified as having day-to-day-control must file.
- Mortgagees
- Public housing agency
- Any individual or entity determined by HUD not to exercise financial or operational control



Required for Previous Participation Review

- Must be clear enough so that a person not familiar with the project and its entities involved can understand the ownership and control structure
- Not everyone listed on the organizational chart must file previous participation
- No template; each chart must match the organization outlines



GC Working Capital Analysis



- **Work in Progress Schedule**

- Need contract amount, % complete, remaining balance, retainage
- Eliminate jobs 90% or more complete
- Is the GC in negotiations on any other contracts?



- **Historical Operating Statements**

- 3 years of audits and Year to Date
- Look at all four years for consistency in income and expenses, and assets and liabilities – question significant changes
- Request bank statements for cash and investment accounts to verify liquid assets
- Evaluate the Current Assets and Current Liabilities – are they classified correctly? Current assets are those assets that can be liquidated quickly or are expected to be received within 12 months.



- **Aging Accounts Receivables**

- What are the expectations of collecting of anything over 90 days old
- Adjust Current Accounts Receivables

- **Bonding Capacity**

- Does the GC have remaining bonding capacity to cover your project?
- Is the GC in negotiations on any other contracts?
- Talk to the Bonding Agent



- **Lines of Credit**

- Evidence of LOC. How long is the LOC good for? Have they ever drawn on it?

- **Other Business Concerns**

- Are there affiliates that money transfers back and forth.
- Intercompany loans?
- Loans to Principals?



Be Aware!

- Evaluate Working Capital early! Worse thing that could happen is you wait until you have the HUD-2328 and find out there are issues with the 5%.
- Identify problem areas early – talk to the CFO or Comptroller – make sure you clearly understand the assets and liabilities.
- Not all contracts are the same! There are some states that allow “Paid when Paid” clauses. HUD does not allow for their construction contracts but if the GC uses in non-HUD contracts, this could make a difference in your analysis.