
CHAPTER 2. LENDER ELIGIBILITY, APPLICATION, APPROVAL AND MONITORING

- 2-1. ELIGIBLE LENDERS. A lender under this program shall meet the requirements of 24 CFR 255.7 and qualify as an HUD-approved lender under 24 CFR 203.3 through 203.6 and 203.8(b). Details regarding required procedures to become a HUD-approved lender under 203 are set forth in Handbook 4060.1, Mortgage Approval Handbook.
- 2-2. LENDER APPLICATION PROCEDURE. In order to be approved as a coinsurance lender, written narrative application (an original and at least two copies) must be made to HUD, 451 7th Street, S.W., Washington, DC 20410 Attn: Director, Office of Multifamily Housing Development. The application, incorporating all required Exhibits, should be bound in a loose leaf form and assembled according to the following Sections:
1. Request for approval (transmittal letter);
 2. Financial (audit reports, financial statements, certification as to maintenance of sound capital resources);
 3. Corporate background (history, structure, multifamily experience, legal opinion to participate);
 4. Staffing (immediate, contract, monitoring);
 5. Procedures (narrative and graphic) covering loan origination, underwriting (including "chief underwriter"), loan approval, legal, loan closing, management (oversight, servicing, disposition);
 6. Resumes;
 7. Certifications; and
 8. Delegations of authority.

Each certification must be prepared individually on a separate letterhead page, each dated and signed by an authorized official of the lender.

The following Exhibits are required:

- a. A written opinion of its counsel that it has the necessary powers to participate in the coinsurance program as provided in Section 307 of the HCD Act of 1974 and 24 CFR Part 255 of the Code of Federal Regulations.

- (2-2) b. Evidence satisfactory to the Commissioner that it has sound capital resources acceptable to the Commissioner of not less than \$1,500,000, of which at least \$500,000 must be liquid funds consisting of cash or readily convertible assets and/or an undrawn unconditional and irrevocable firm letter of credit up to \$500,000, issued by a supervised financial institution with assets of not less than \$100,000,000. Not more than \$500,000 of the sound capital resources can be met by means of the letter of credit. It shall also agree to at all times maintain such sound capital resources plus an additional amount equal to \$1 in sound capital resources for each \$300 of outstanding principal indebtedness of mortgages it has coinsured under this program. In determining sound capital resources for purposes of the 223(f) coinsurance program, coinsurance loss reserves are considered unencumbered reserves. Should a letter of credit be utilized to meet the sound capital resources or liquid fund requirements, a conformed copy of the letter of credit must accompany the submission.

"Sound capital resources" means the excess of the mortgagees' assets (net of any valuation allowances) over its liabilities, generally referred to as its net worth, including paid-in-capital stock, surplus, reserves, undistributed earnings and any other unencumbered resource of the mortgagee which may include, for purposes of this program, an unconditional and irrevocable firm letter of credit as noted above, less nonacceptable assets as defined by HUD. See HUD Handbook IG 4000.3 REV, Audit Guide for Audits of HUD-Approved Non-Supervised Mortgagees for Use by Independent Public Accountants, for a definition of nonacceptable assets.

NOTE: The Government National Mortgage Association (GNMA) imposes separate requirements with respect to securities which it guarantees which are backed by mortgages coinsured pursuant to this program. While these requirements must also be met by coinsuring lenders seeking to use the securities program, the same resources evidenced for approval as a coinsured lender may also be used to meet GNMA's requirements. GNMA requirements are contained in the GNMA Mortgage-Backed Securities Guide.

- c. A detailed written description of its proposed coinsuring operating procedures evidencing that it has the ability, either through technical staff in its immediate employ and/or through contracts with persons or firms not on its staff, for discharging full mortgage processing, underwriting,

- (2-2) oversight, servicing, management and property disposition functions in a manner consistent with the program objectives. See paragraph 2-3.
- (1) If a lender proposes to use its own staff, information must be provided identifying the permanent staff employed to carry out processing, underwriting, oversight, servicing, management and property disposition functions and detailed resumes of principal staff responsible for each discipline must be provided.
 - (2) If a lender proposes to contract with persons or firms not in its immediate employ for the purpose of carrying out any of the functions, such persons or firms must be identified at the time the lender applies for participation in the program and resumes of their qualifications and previous experience provided. Alternatively, in the categories specified in paragraph 2-3b and h, the lender may submit a certification which indicates that it will comply with the HUD standard for certain employees under outside contract.
 - (3) Where a lender proposes to contract with others for the performance of technical processing, it must identify those persons in its immediate employ who will monitor the performance of all work done under contract. Resumes for these persons must evidence sufficient professional and technical competence in areas appropriate to their monitoring responsibilities such as appraisal, cost analysis, financial and credit analysis, architectural, engineering, loan servicing, management and disposition. Such person(s) may or may not be the same person(s) responsible for reviewing all areas of mortgage underwriting, e.g., chief underwriter.
 - (4) In any event, the lender is fully responsible for all determinations made.
- d. A statement agreeing to notify the Commissioner promptly in writing of any adjustments in its processing procedures or personnel which takes place after its application is submitted and agreeing to make no adjustments which are inconsistent with the instructions contained in this handbook.
 - e. The most recent detailed audit report of its books and records performed by an independent certified public accountant or by an independent public accountant licensed by regulatory authority of a State or other political subdivision on or

- (2-2) prior to December 31, 1970. The audit must be supplemented by such additional information as the Commissioner may request. If the CPA- or IPA-prepared balance sheet is more than six months old, a current balance sheet prepared by management and signed and certified by a senior corporate officer of the applicant lender must also be submitted.
- f. A statement agreeing to file with the Commissioner annual audits similar to those required in e above: (a) at such time as may be required pursuant to applicable state law or, in the event there are no such applicable requirements, (b) within 75 days after the closing of its fiscal year, or (c) at such other times as requested by the Commissioner. The annual audit reports must be in compliance with HUD Handbook IG 4000.3 REV. They should include statements from the IPA as to the outstanding principal indebtedness of those mortgages it has coinsured under the multifamily coinsurance program, the amount of liquid funds available, and sound capital resources.
 - g. A statement agreeing to submit to periodic auditing and review by the Commissioner, the Inspector General or the Comptroller General of the United States regarding its participation in the coinsurance program.
 - h. A statement agreeing to abide by all applicable requirements issued by the Commissioner for discharging its underwriting, servicing, management oversight and property disposition functions pursuant to this program and agreeing to use all standard forms prescribed by this handbook for such purposes.
 - i. A statement certifying as follows:

"I (we) hereby certify that _____ (name of lender) _____ shall comply with the provisions of Title VIII of the Civil Rights Act of 1968, as amended, the Equal Credit Opportunity Act, Executive Orders 11063 and 11246, as amended, other Federal laws and all regulations issued pursuant to these authorities with respect to the lending, investing or coinsuring of funds in real estate mortgages."
 - j. A designation of official(s), including appropriate signatures, authorized by the lender to execute commitments, certifications, agreements, and documents utilized in connection with loans to be coinsured under this program. The statement must provide that the designation(s) will remain in effect until withdrawn and that the lender will notify HUD of any changes in such designation(s).

- 2-3. PERSONNEL. The lender must employ, at the staff level, a knowledgeable person(s) (e.g., chief underwriter) who possesses a general understanding of mortgage financing and project development to oversee and evaluate findings and recommendations in all areas of mortgage financing and development, acquisition, rehabilitation of buildings and land improvements as well as the appraisal, architectural and engineering, cost estimation, financial and mortgage credit analysis, legal services, property management, loan servicing and property disposition functions normally associated with multifamily projects.

In those instances where the lender contracts out for such services as appraisals, cost estimation, architectural and engineering, project management, etc., the lender is not relieved of its obligation for program administration and management, nor for the technical and professional acceptability of such contracted services and must have staff capability to supervise, evaluate and monitor the quality of these services and to use the determinations derived to reach acceptable underwriting determinations.

The financial administration aspects of lender operations may not be contracted to private sources with the exception of services pertaining to its annual certified financial statements.

The lender must employ, directly or by contract, qualified individuals with the responsibility for each of the following functions and underwriting disciplines:

- a. Cost of construction. The lender may employ an individual or firm knowledgeable in construction cost estimating techniques with experience in general construction cost estimating and two years experience in the multifamily area. The individual or firm employed to perform this function must have no identity of interest with the mortgagor or the contractor who will perform the repairs to the project. The cost processing work relative to the repair cost estimation connected with the project may be performed by the architect if the person demonstrates the qualifications necessary to perform the repair cost estimation function.
- b. Architectural and engineering. The individual(s) must have professional qualifications as evidenced by registration in any state or graduation from an accredited school of architecture. Firms consisting of individuals who meet these qualifications may also be eligible for approval.

- (2-3) c. Appraisal. The education level and experience of staff appraisers as well as fee appraisers must equal or exceed standards for comparable HUD staff. Specifically, an appraiser of multifamily properties must have a minimum of six years of real estate appraisal experience with at least three years of specialized experience in the appraisal of multifamily residential properties. Membership in a professional appraisal organization, though desirable, is not a requirement for participation in this program.
- d. Mortgage Credit. The individual must have at least 3 years of general experience in either banking, accounting, finance or commercial lending and 3 years specialized experience in multifamily mortgage financing. The individual must have the ability to analyze corporate financial statements and evaluate the credit acceptability of individuals, partnerships and large corporations. These statements will include, but are not limited to, balance sheets, income statements and statements of changes in financial position. The individual must have a broad knowledge of mortgage lending practices, construction lending practices and the financial structure of large corporations.
- e. Management analysis/oversight. Personnel must have the experience and capacity to review and determine the acceptability of project management agents and operating procedures, analyze project financial conditions, identify management problems and their causes and work with owners to develop solutions to those problems. Additionally, project managers must conduct on-site and desk reviews to insure operation of the project in accordance with acceptable management practices and the requirements of the Regulatory Agreement.
- f. Loan servicing. Personnel must have experience in loan collections, escrow management, tax and insurance accruals, resolving delinquencies, establishing work-out plans, etc.
- g. Property disposition. Personnel must have experience in the interim management of acquired projects and must be able to assist the legal staff in the disposition of such projects.
- h. Legal. Personnel must be duly licensed and have at least 2 years experience in the field of real estate. Attorneys who render opinions concerning local real estate law must be licensed in the jurisdiction where the project is located.

- 2-4. REVIEW AND APPROVAL PROCEDURE. When the documentation required in paragraph 2-2 above is received, it will be evaluated and, if acceptable, an on-site review of the lender's facilities and operating procedures will be scheduled.
- a. Evaluation. Each on-site review will involve an evaluation of the lender's operations, internal controls, adequacy of technical staff, procedures for screening and processing applications for mortgage insurance; capability to service such mortgages, review and supervise project management and carry out property disposition (including instructional manuals for each of the foregoing disciplines). Where a lender utilizes the services of outside technical or professional assistance in its underwriting operation on a contract basis, the adequacy of the lender's capability to review and monitor the quality of the performance of such services will also be subject to review and evaluation.
 - b. Approval. Upon a determination by HUD that a lender has the financial capacity, staff, facilities, procedures and the organization necessary to carry out a sound underwriting operation in connection with the coinsurance program, and that all necessary evidence and statements are submitted and acceptable, HUD will notify the lender of approval, subject to HUD review of the first three applications for loans to be coinsured under the program (see paragraph 12-2).
 - c. Non-approval. Should HUD be unable to make a determination based upon the material submitted or if an unsatisfactory finding is made, the lender will be so notified.

2-5. MONITORING AND CONTROL.

- a. HUD review. Neither HUD Headquarters or field offices will be involved in the normal review and approval functions of the coinsurance process as performed by the lender except for the previous participation requirements (see paragraph 5-3). All other functions will be performed exclusively by the coinsuring lender. At HUD endorsement, only the documentation required in paragraph 12-5 is to be submitted and will not be subject to HUD content review prior to endorsement.
- b. Post-endorsement procedures. An approved lender is subject to on-going monitoring and periodic on-site post commitment review by HUD to assure adherence to statutory and regulatory requirements. This review will include an evaluation of the lender's management, internal control, technical

(2-5) underwriting, closing procedures, mortgage servicing, etc. The evaluation will also include sufficient processing review to ascertain that underwriting decisions made are consistent with underwriting guides set forth by HUD and that technical processing, construction and operation of projects are consistent with established lending and underwriting practices in accordance with the intent of the program, and the lender's application.

c. Reporting. To facilitate the monitoring and review process, the lender must provide the following information to the Commissioner; Attention, Office of Multifamily Housing:

- (1) Annual audits as required by paragraph 2-2f above. Note that this requirement does not relieve the lender of its responsibility to submit annual audits to the HUD Office of Lender Certification.
- (2) Prompt notification to HUD of any changes in its processing procedures or personnel which take place after its certification as an approved coinsurance lender, so that these changes may be reviewed for consistency with program requirements. HUD approval of the new procedures and/or the new personnel must be received by the lender prior to the issuance of commitments based upon the new procedures or upon work performed by the successor.
- (3) When an outside organization or personnel which had been approved in lieu of the lender's staff to provide on-going processing or management services in connection with the coinsurance program is replaced, the lender must notify HUD in writing when a successor is appointed and receive HUD approval of such successor prior to the issuance of coinsurance commitments based upon the successor's conclusions. Such notification shall be accompanied by a biographical history of the new contractor unless the lender certifies that the contractor meets the standards of paragraph 2-3b or h, in which case the lender's certification that all such personnel meet these standards, will suffice.
- (4) A copy of each firm commitment it issues and a copy of each amendment and/or extension thereto, as well as a copy of each reopened commitment. This copy must be transmitted to HUD concurrent with issuance of the document by the lender.

- (2-5) (a) This information is necessary to project the amount of coinsurance expected to be endorsed in order to assure that statutory limitations on the amount of such insurance are not exceeded.
- (b) Should the amount of coinsurance loans under the program approach the statutory limitation, lenders will be notified accordingly.

2-6. AUDITING. In addition to monitoring and periodic review of its underwriting, mortgage servicing and property disposition activities, the lender shall submit to periodic audit and review by the Commissioner, the Inspector General, or the Comptroller General. Audits performed by the Commissioner will include a financial management review and a review of the lender's quality control plan as required by HUD Handbook 4060.1, Mortgagee Approval Handbook.

2-7. CAUSE FOR SUSPENSION OR TERMINATION. Action may be taken against an approved 223(f) coinsurance lender as a result of a departure from approved procedures, the loss of and failure to replace skilled staff resources or neglect of mortgage insurance, loan servicing and management and property disposition responsibilities. Other specific causes for action include the following:

- a. Failure to maintain appropriate sound capital, resources;
- b. Failure to perform underwriting, servicing or property disposition functions in a manner consistent with the requirements of this handbook and the lender's approved application;
- c. Failure to discharge responsibilities under a Regulatory Agreement or the contract for coinsurance;
- d. The transfer of a coinsured mortgage to a lender not approved by the Commissioner;
- e. The failure to segregate and deposit in a special account(s), in FDIC, FSLIC, or NCUA institutions, all escrow funds received from mortgagors for, but not limited to, ground rents, taxes, assessments and insurance premiums and to deposit such funds to a special account or accounts;
- f. The use of escrow funds for any purpose other than that for which they are received;

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- (2-7) g. The payment by the lender, its employees, agents, or its contractors, of any fee, kickback or other consideration

- directly or indirectly, in connection with any insured mortgage transaction or transactions with any person including an attorney, escrow agent, title company, consultant, mortgage broker, seller, builder or real estate agent, if such person has received any other payment or other consideration from the mortgagor, the seller, the builder or any other person for services related to such transaction or transactions or from or related to the purchase or sale of the mortgaged property, except that compensation may be paid for the actual performance of additional services with prior approval of the Commissioner;
- h. The failure to notify HUD, and obtain HUD approval where necessary, of changes in staffing or procedures, as required by paragraph 2-2d and j of this handbook (see paragraph 2-5c(2) and c(3)).
 - i. A finding by a Federal agency of major non-compliance with any regulation or procedure issued pursuant to Executive Order 11063, Title VIII of the Civil Rights Act of 1968, or any contractual provision relating to Civil Rights concerns.
 - j. Such other concerns as the Commissioner determines to be justified in accordance with the applicable statutes, regulations and administrative rules.
- 2-8. REINSTATEMENT. Suspension or termination of a lender's coinsuring authority may be cured by removal of the cause. Following any suspension or termination action, the lender will serve a probationary period. During this probation, HUD will review each application and the lender's underwriting associated therewith prior to granting any coinsurance authority.
- 2-9. DEPLETION OF RESERVES. The regulations provide for suspension or withdrawal of approved lender status for failure to maintain satisfactory sound capital resources. In the event payment of a coinsurance claim temporarily reduces sound capital resources below the level required in 2-2(b) above, HUD will allow the lender reasonable time, not to exceed six months, to restore its required reserves before taking any formal action. In the meantime, the Commissioner will refrain from endorsing any credit instruments submitted by the lender for coinsurance endorsement during the period of its reserve deficiency. This moratorium on originations does not affect the lender's outstanding coinsurance contracts or its servicing of existing coinsured mortgages. Outstanding firm commitments presented for endorsement would be subject to a case-by-case review in such circumstances.