

U. S. Department of Housing and Urban Development
Washington, D.C. 20410-8000

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OFFICE OF THE ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

MORTGAGEE LETTER 2002-01

**TO: ALL APPROVED MORTGAGEES
ALL APPROVED NONPROFIT AGENCIES**

**SUBJECT: Nonprofit Participation in Single Family FHA Activities -
New Requirements and Restrictions**

This Mortgagee Letter clarifies the requirements that new nonprofit applicants must meet to participate in FHA's Single Family activities, including purchasing discounted HUD Homes, serving as mortgagors, and offering secondary financing assistance. Nonprofits that are seeking FHA approval, and FHA-approved nonprofits currently listed on the nonprofit roster seeking re-approval at the expiration of their current certification, must meet the requirements of this Mortgagee Letter and Mortgagee Letter 00-08. Mortgagees must assure that nonprofit mortgage loan applicants meet the eligibility criteria and comply with the required disclosures. The changes described in this Mortgagee Letter and attachments are effective 30 days from the date of this letter.

**NEW POLICY DIRECTIVES: RESPONSIBILITIES OF THE MORTGAGEE AND THE
NONPROFIT AGENCIES**

Currently, mortgagees may not approve an application for FHA mortgage insurance from a nonprofit agency without verifying its approval status, applicable geographical restrictions, and specific restrictions on property inventories. This Mortgagee Letter supplements and clarifies FHA's current requirements for nonprofit participation in FHA programs and review requirements for mortgagees, as stated below.

General Clarification

Because this Mortgagee Letter is intended to clarify a number of application requirements for nonprofits interested in participating in FHA's programs, an updated application checklist is attached (Attachment 1). This new application guide supercedes the checklist provided to nonprofits in Mortgagee Letter 00-08. In addition, the Affordable Housing Program Format

(Attachment 2) has been revised slightly, to clarify FHA's requirements. This new version also supercedes the version attached to Mortgagee Letter 00-08.

Conflict of Interest Issues

The Department has a responsibility to ensure that no conflict of interest exists between nonprofit agencies, their boards of directors, their principal staff or any other entities that may participate in operating their affordable housing programs. Therefore, FHA will require that members of the board of directors (Chief Executive Officer, President, Vice President, Secretary, and Treasurer - excluding non-voting members) and salaried or voluntary principal staff (Executive Director/President or Vice President, Project/Program Director, or similar position) provide their social security numbers (SSN) to FHA. FHA will keep the SSNs confidential. The SSNs will be used only to assure the Department that no conflict of interest relationship exists and the board and staff have no outstanding unpaid government loans, sanctions, foreclosures, inappropriate transfers of real property, business relationships, etc.

It is a conflict of interest for a nonprofit to employ staff who also work for and receive financial benefits from a for-profit entity that is providing the nonprofit with services related to the nonprofit's affordable housing plan. Board members must serve on a voluntary basis, and may not be paid nor receive any compensation for any services they provide in the implementation of the nonprofit's affordable housing program. FHA will collect information on the job responsibilities of all Board members to ensure that their occupational activities and obligations do not conflict with the work of the nonprofit. HUD strictly prohibits the sale or lease of properties with FHA financing and/or discounted HUD Homes to any of the nonprofit's officers, directors, elected or appointed officials, employees, or business associates, either during their tenure or for one year thereafter, or to any individual who is related by blood, marriage, or law to any of the above.

Ineligible Participants

To be approved and to maintain approval, neither the nonprofit, nor any officer, partner, director, principal or employee shall:

- Be suspended, debarred, or otherwise restricted under the Department's regulations in 24 or 25 CFR, or similar procedures of any other Federal agency.
- Be indicted for, or convicted of, an offense which reflects upon the responsibility, integrity, or ability of the nonprofit to participate in FHA activities.
- Be subject to unresolved findings as a result of HUD or other government audits or investigations.
- Be engaged in activities that do not conform to generally accepted practices of prudent nonprofits or that demonstrate irresponsibility.

These requirements are applicable at the time that the nonprofit applies for approval and at all times while it is an approved nonprofit.

Consultant Services

Nonprofit agencies must have the administrative capacity to develop and carry out their FHA approved homeownership plans in a timely and successful manner. Nonprofits that obtain consultant services to help implement their homeownership programs are not relieved from this requirement. The nonprofit's operations must be independent of the influence, control, or direction of the consultant or any other outside party, particularly those seeking to derive profit or gain from a proposed project (such as, but not limited to, landowners, real estate brokers, bankers, contractors, builders, or consultants). Therefore, to assure that the consultant services are provided on an 'arms length' basis, the nonprofit must disclose any written and/or side agreements with parties that may derive financial gain through the homeownership program. Disclosure should identify the name of the business entity, and the individuals from the company who will be working with the nonprofit, the terms of the relationship and how the party will be compensated. Failure to adequately disclose may result in a conflict-of-interest determination.

In addition, consultant services - administrative, management, financial, or otherwise - provided under an independent contractor relationship (as opposed to employer-employee relationship) shall not constitute more than half of the nonprofit's activities. This measurement will be calculated by evaluating: the ratio of nonprofit staff to contracted or consultant staff; the ratio of hours devoted to the implementation of the Affordable Housing Plan by nonprofit staff versus contracted or consultant staff; and the funds devoted to paying nonprofit staff compared to those paying contracted or consultant staff. In other words, the nonprofit must have the in-house resources and capacity to run its own programs, and contract for services on a temporary and supplementary basis.

Financial Capacity

Nonprofit agencies must have the financial capacity to operate their homeownership programs. Nonprofits will be required, if applicable, to submit the following with their application or recertification package so that FHA may assess each organization's financial stability in terms of cash balances, assets and liabilities, annual expenses, and cash flow from operations:

- Consistent with the requirements of the Single Audit Act Amendments of 1996 (31 U.S.C. §§7501-07), nonprofit applicants that expended **\$300,000 or more** in Federal awards in the most recent fiscal year are required to submit for such fiscal year a financial audit by the applicant's Independent Public Accountant certifying that the applicant maintains internal controls over Federal awards; complies with

applicable laws, regulations, and contract or grant provisions; and prepares appropriate financial statements. 'Federal awards' include discounts associated with the purchase of HUD Homes and FHA-insured financing, as defined in OMB Circular A-133, "Audits of States, Local Governments, and Nonprofit Organizations," with which the audit must be in conformance. Additionally, applicants are required to submit their most recent quarterly financial statement along with certification from a CPA or other financial professional attesting that this information accurately represents the financial condition of the nonprofit agency.

- Applicants that expended **less than \$300,000** in Federal awards in the most recent fiscal year must submit a complete, un-audited year-end financial statement for such fiscal year, prepared in accordance with generally accepted accounting principles and reporting practices and must include an auditor's review report, a treasurer's report and any supplemental schedules. Additionally, applicants are required to submit their most recent quarterly statement, along with certification from a CPA or other financial professional attesting that this information accurately represents the financial condition of the nonprofit agency.

Based on an analysis of submissions, FHA may limit the number of properties a nonprofit may purchase at a discount and/or purchase with FHA-insured financing.

Nonprofit Status

Eligible nonprofits must have two years 501(c)(3) IRS tax-exempt status. Nonprofits must submit to FHA their IRS letter of determination to prove their 501(c)(3) tax-exempt status. In addition, nonprofits must certify compliance with IRS regulations that require nonprofits to notify the IRS of any substantial and material changes in the nonprofit's character, purpose, or methods of operation [IRS Reg. 1.501(a)-1(a)(2)601.201(h)(3)(ii)]. Finally, nonprofits may not assume the name and employer identification number (EIN) of another dormant or defunct nonprofit.

Clarification of Experience Criteria

Nonprofit agencies must meet strict housing development experience requirements. The nonprofit must have a minimum of two consecutive years, within the last five years, of housing development experience. Housing development experience is defined as acquisition, rehabilitation, and sale to low-to-moderate income persons. Hiring of experienced personnel does not relieve the nonprofit of the experience requirement. Organizations that do not meet this experience requirement may be able to obtain limited approval if they have at least one

year of housing development experience and one year of other related housing provider experience. To be considered, the organization's "other related housing experience" must demonstrate that the organization has the financial and administrative capacity to purchase, rehabilitate and resell homes to low to moderate-income families.

Adequate Facilities

To ensure that all approved nonprofits have adequate space for employees and records, FHA will now require the submission of photographs and floor plans for the agency's facilities. This new requirement is identical to the requirement for lenders seeking FHA approval.

Additionally, nonprofits must have office(s) located within a 200 mile radius of the geographical areas in which they plan to do business, as identified in the nonprofit's Affordable Housing Plan. For each office, nonprofits are required to have adequate office space, equipment and clerical assistance, so that employees may perform their duties in a responsible manner. This includes, but is not limited to, a desk, telephone, and photocopying equipment. A nonprofit's main office must be its designated facility to which the Department directs all communications about the management affairs of the nonprofit, and from which the public obtains information on the activities of the nonprofit.

The nonprofit's facilities must be located in a space that is separate and apart from any other entity. A nonprofit may share general reception-type entrances or lobbies with another business entity or nonprofit. However, the facilities must be clearly defined to the public, so that visitors will know, at all times, exactly with which entity they are doing business. This includes a sign and other common means of identification used by nonprofits and business entities.

Evidence of Performance

Nonprofits applying to continue participating as Mortgagors must submit to HUD information on the performance of all of their FHA-insured loans, as described in Attachment 1, #15. HUD will examine property purchase prices and dates, resale prices and dates, default rates, and evidence of rehabilitation completion (in the case of 203(k) loans) to assess the nonprofit's capabilities and compliance with FHA requirements.

Quality Control Plan

As a condition of approval to participate in FHA activities, nonprofits must submit a written Quality Control Plan that explains the organization's internal and external audit and monitoring procedures. The Quality Control Plan must include

periodic reports that identify for senior management areas of deficiency, including fraud or violations of FHA regulations and its own policies and procedures, errors and omissions, and unacceptable patterns or trends. The Quality Control Plan must describe in detail the nonprofit's review procedures and outline the corrective actions to be initiated immediately when discrepancies are found.

Reporting Requirements

With the issuance of this Mortgagee Letter, nonprofits will be required to include in their annual reports information on *all* REO properties purchased at a discount - 10% or higher. These reports are due each February to the Homeownership Center Director and provide information about the nonprofit's program accomplishments over the past calendar year (See Mortgagee Letter 00-08, Attachment 3). Previously, only nonprofits that purchased REO properties at a 30% discount were required to submit this annual report. Properties purchased under an Asset Control Area (ACA) agreement must be included in the report, but listed separately from other purchases.

In addition, nonprofits must submit a list of all business partners participating in the rehabilitation and resale of the property. The list should include the name of the company, the name of the principals, the name and title of all staff with whom the nonprofit is working, a description of the services provided by the company, and an account of the costs and fees associated with those services. This information must be reported for all real estate agents, lenders, and contractors involved in the rehabilitation and sale of REO property.

Record-Keeping Requirements

In order to accommodate on-site reviews, the non-profit agency should maintain records in a specific format. Attachment 4 lists the required items to be included in each property file. Files should be maintained individually for each property purchased, sold, or leased. In addition to the individual property files, other documents should be maintained for review and are listed in Attachment 4. Accounting records should be maintained in a property specific format so that cost calculations can be made for all expenses related to each specific property. Files should be maintained for a minimum of three years after the property is sold by the nonprofit.

Mortgagee Responsibilities

As established in Mortgagee Letter 00-08, mortgagees may not process any loan application on behalf of a nonprofit agency without an approval letter, dated within the past two years, verifying that the nonprofit is a participating agency and identifying any conditions or limitations placed on the nonprofit's activities. In addition, the mortgagee

is responsible for assessing the financial and management capacity of the nonprofit to carry out its affordable housing program. The Credit Evaluation responsibilities of the mortgagee are detailed in Mortgagee Letter 00-08, Attachment 6. HUD will also use a Financial Capacity Worksheet (Attachment 3) to evaluate the nonprofit's financial capacity when certifying nonprofits for participation in FHA programs. This worksheet may also be used by the mortgagee's underwriters to assist in assessing the nonprofit's financial condition.

Information Collection Requirements

The information collection requirements referred to in this Mortgagee Letter have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. Chapter 35). The OMB number issued for this requirement is OMB 2502-0540.

Questions regarding this Mortgagee Letter should be directed to the FHA Homeownership Centers in Atlanta (1-888-696-4687), Denver (1-800-543-9378), Philadelphia (1-800-440-8647) and Santa Ana (1-888-827-5605).

Sincerely,

John C. Weicher
Assistant Secretary for Housing-
Federal Housing Commissioner