

**DEPARTMENT OF HOUSING AND  
URBAN DEVELOPMENT**

**24 CFR Part 200**

[Docket No. FR-5850-F-04]

RIN 2502-AJ28

**Retrospective Review—Improving the  
Previous Participation Reviews of  
Prospective Multifamily Housing and  
Healthcare Programs Participants**

**AGENCY:** Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

**ACTION:** Final rule.

**SUMMARY:** This final rule revises HUD's regulations for reviewing the previous participation in federal programs of certain participants seeking to take part in multifamily housing and healthcare programs administered by HUD's Office of Housing. The final rule clarifies and simplifies the process by which HUD reviews the previous participation of participants that have decision-making authority over their projects as one component of HUD's responsibility to assess financial and operational risk to the projects in these programs. The final rule, together with an accompanying Processing Guide, clarifies which individuals and entities will undergo review, HUD's purpose in conducting such review, and describe the review to be undertaken. By targeting more closely the individuals and actions that would be subject to prior participation review, HUD not only brings greater certainty and clarity to the process but provides HUD and program participants with flexibility as to the necessary previous participation review for entities and individuals that is not possible in a one-size fits all approach. Through this rule, HUD replaces the current previous participation regulations in their entirety.

**DATES:** *Effective Date:* November 14, 2016.

**FOR FURTHER INFORMATION CONTACT:** Danielle Garcia, Office of Housing, Department of Housing and Urban Development, 451 7th Street SW., Room 6148, Washington, DC 20410; telephone number 202-402-2768 (this is not a toll-free number). Individuals with speech or hearing impairments may access this number through TTY by calling the toll-free Federal Relay Service at 800-877-8339 (this is not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

**I. Background**

HUD's Previous Participation Review regulations, codified at 24 CFR part 200, subpart H (Subpart H regulations), set

forth the HUD process, which applicants seeking to participate in HUD's multifamily housing and healthcare programs must undergo to ensure, including providing a certification, that all principals of the applicant involved in a proposed HUD project have acted responsibly and have honored their legal, financial, and contractual obligations in their previous participation in HUD programs, as well as in certain programs administered by the U.S. Department of Agriculture, and in projects assisted or insured by state and local government housing finance agencies. HUD's regulations governing the assessment of previous participation require applicants to complete a very detailed and lengthy certification form (HUD Form 2530).<sup>1</sup>

The 2530 form requires disclosure of all principals to be involved in the proposed project, a list of projects in which those principals have previously participated or currently participate in, a detailed account of the principals' involvement in the listed project(s), and assurances that the principals have upheld their responsibilities while participating in those programs. HUD's Subpart H regulations govern not only the content of the certification submitted by applicants, but the types of parties that must certify, the process for submitting the certification, the standards by which submissions are evaluated, and the delegations and duties of HUD officials involved in the evaluation of the certifications. The regulations also contain procedures by which applicants can appeal adverse determinations.

The Subpart H regulations, first established in 1980, with some updates over the years, were overdue for significant updating to reflect the deal structures and transaction practices taking place today that were not in place over 20 years ago. For example, the currently codified regulations pre-date the development of limited liability companies as an organizational entity. HUD recognized that the currently codified regulations have not kept step with contemporary organizational structures or transactional practices, and were both over-inclusive and under-inclusive of applicants that should undergo the previous participation review process, creating unnecessary burdens for participants and HUD alike. Further, participants in HUD's multifamily housing and healthcare programs have long complained about the delays with the previous participation review process because of

the overly detailed information required to be submitted. Complaints focused on the difficulties associated with obtaining information from all the limited partner investors in individual projects and in duplicating information for multiple levels of affiliates. Participants in HUD's multifamily housing and healthcare programs also stated that the previous participation process requires participants to complete the Form 2530 for each project, regardless of the number of Forms 2530 each participant completed in the recent past, regardless of how many projects the participant is involved in each year, and regardless of whether the participant is a well-established, experienced institutional entity already familiar to HUD.

**II. The Proposed Rule**

On August 10, 2015, at 80 FR 47874, HUD published a proposed rule that is designed to comprehensively overhaul the Subpart H regulations.<sup>2</sup> As described in the August 10, 2015, proposed rule, HUD made several efforts over the years to improve the process and minimize the time and collection burden it takes to undergo the previous participation review process, but none of the efforts achieved the success that HUD desired.<sup>3</sup> Therefore on August 10, 2015, HUD submitted a rule for public comment that proposed to revise the Subpart H regulations in their entirety, replacing the current prior participation review process. The August 10, 2015, proposed rule noted that while the current regulations mandate that Form HUD 2530 be used, the proposed rule would shift the emphasis of the regulations from this specific form to the substance of what is being asked from whom. One of the goals of the August 10, 2015, proposed rule is to provide HUD and its program participants with greater flexibility by avoiding a one-size-fits-all approach, and allowing for HUD to seek information tailored to certain programs, expand electronic data practices for gathering information, and decrease the information collection imposed, generally across-the-board on all applicants regardless of the applicant entity and the program to which the applicant seeks to participate. The specific changes proposed by the August 10, 2015 rule can be found at 80 FR 47876 through 47877.

At the close of public comment period on October 9, 2015, HUD received 33

<sup>2</sup> See <https://www.gpo.gov/fdsys/pkg/FR-2015-08-10/pdf/2015-19529.pdf>.

<sup>3</sup> See preamble to proposed rule at 47875 and 47876.

<sup>1</sup> See <http://portal.hud.gov/hudportal/documents/huddoc?id=2530.pdf>.

public comments. Overall the commenters were supportive and appreciative of HUD's efforts to reform the regulations. Commenters stated that, in addition to reforms to the regulations and reforms to the review process, additional guidance and training materials were also needed. Several commenters stated, however, that the regulations were broad and vague and lacked the specificity that participants desired to bring clarity and certainty to the previous participation review process. The public comments and HUD's responses to the public comments on the proposed rule are addressed in Section V of this preamble.

### III. Supplemental Notice of Proposed Rulemaking

On May 17, 2016, at 81 FR 30495, HUD supplemented its August 10, 2015, proposed rule with a Supplemental Notice of Proposed Rulemaking (Supplemental Notice). To address commenters' concerns about the need for more specificity in the proposed rule, HUD proposed through this supplemental document to use an approach that HUD has taken in certain of its other regulations and that is to supplement codified regulations with a document specifically referenced in the codified regulations that addresses the specific procedures (processing requirements) to be followed.<sup>4</sup> When HUD has taken this approach, HUD commits to provide notice and opportunity for comment for any significant changes made to the document.

In the May 17, 2016, document, HUD proposed to issue with its final regulations a "Processing Guide for Previous Participation Reviews of Prospective Multifamily Housing and Healthcare Programs' Participants" (Processing Guide). This Processing Guide, to be posted on HUD's Web site, will provide the details on procedures which commenters are seeking and which HUD proffered is more appropriate for a process guide than for regulatory text. As provided in the May 17, 2016, document, HUD advised that the Processing Guide will provide applicants for and participants in HUD's multifamily housing and healthcare programs the detailed information desired on the previous participation

review process, information about how "flags" are assigned and addressed,<sup>5</sup> and elaborates on terms and information in Form 2530. HUD provided that the codified regulations would reference the Processing Guide and provide a 30-day advance notice and comment period for significant changes proposed to the Processing Guide. HUD reiterated that the Processing Guide offered an appropriate procedural approach for addressing the previous participation review process because it would give HUD the ability to make changes as may be needed or desired by HUD as well as program participants to address specific procedural circumstances that may arise in the previous participation process and to keep up-to-date with changes that may arise in the housing market. HUD noted that one of the longstanding complaints about HUD's previous participation review process is that the process and the regulations that govern the process are very outdated and do not keep up with the times. HUD submitted that a lean set of regulations supplemented by a detailed processing guide that is subject to notice and comment for any significant changes is the best approach for this process and one that will endure successfully for some time.

The public comment period on the May 17, 2016, notice closed on June 16, 2016, and HUD received 11 comments. The commenters strongly supported this approach but some commenters stated that greater specificity was still necessary. The public comments and HUD's responses to the public comments on the Supplemental Notice are addressed in Section V of this preamble.

### IV. Changes Made at This Final Rule Stage

This section highlights the changes made to the proposed rule at this final rule stage.

- The final rule references the Processing Guide as a supplement to HUD's regulations and provides for changes to the guide to be done through advance notice and opportunity for comment.
- The final rule reorganizes information relating to the evaluation of risk into a separate definition of risk.
- The final rule clarifies that Covered Projects include projects subject to continuing HUD requirements only if those requirements are made in connection with a program

administered by HUD's Office of Housing.

- The final rule revises terminology to clarify that Controlling Participants include both Specified Capacities and the individuals and entities that control the Specified Capacities.
- The final rule includes construction managers as Controlling Participants in hospital projects insured under section 242 of the National Housing Act.
- The final rule specifies that individuals or entities with the ability to direct the day-to-day operations of a Specified Capacity or a Covered Project are Controlling Participants.
- The final rule specifies that board members of a non-profit that do not otherwise control the day-to-day operations of the non-profit are not Controlling Participants.
- The final rule clarifies that a change in Controlling Participants is a Triggering Event if HUD consent is required for such change.
- The final rule provides more detail on when a Controlling Participant may be disapproved from participation in a Triggering Event on the basis of being restricted from doing business with other government agencies.
- The final rule specifies that reconsideration decisions shall not be rendered by the same individual who rendered the initial review.
- The final rule specifies that Controlling Participants shall receive at least 7 business-days advance notice of a reconsideration.
- The final rule eliminates the bid to purchase a Covered Project or mortgage note held by the Commissioner from the list of Triggering Events.

### V. The Public Comments on the Proposed Rule and Supplemental Notice and HUD's Responses

#### A. Comments on the Proposed Rule

#### 1. General Comments on the Proposed Rule

Many commenters expressed support for HUD's initiation of the proposed rule, which was designed to streamline and improve the previous participation process. One commenter stated: "This proposed rule is a step in the right direction to streamline a tedious process in HUD multifamily and healthcare programs." Commenters also suggested changes that they thought would further improve this process. The following are the significant comments raised by the commenters.

*Comment: The proposed rule is overly broad.* Several commenters stated that the proposed regulations are overly broad and open to various interpretations by HUD. The

<sup>4</sup> See, for example, 24 CFR 207.254, pertaining to mortgage insurance premiums; 24 CFR 203.605, pertaining to tier ranking systems and methodology applicable to loss mitigation performance; 24 CFR 290.9, pertaining to setting rental rates for certain multifamily housing projects; 24 CFR 570.712(b) pertaining to setting a fee for the Section 108 Loan Guarantee Program; and 24 CFR part 902, pertaining to scoring notices for HUD's Public Housing Assessment System.

<sup>5</sup> Flags refer to an issue or issues in a prospective participant's application for which further review is necessary.

commenters stated that the final rule should provide a comprehensive outline of the previous participation review requirements so that industry partners and HUD staff alike have a primary resource from which to identify the governing requirements and be detailed enough not to have to be dependent on additional guidance. Commenters stated that it is essential that the process be as transparent as possible. The commenters stated that because the proposed rule does not specify how HUD intends to determine whether Controlling Participants have control over the finances or operation of a Covered Project, this could actually increase the number of responses required by a program participant rather than reduce such processes. A commenter stated that the proposed rule is so vague that HUD may violate the Administrative Procedures Act (APA) if HUD neglects to provide the public a meaningful opportunity to review and comment on forthcoming revisions. The commenters stated that before proceeding to a final rule, HUD must solicit additional comment by re-issuing a revised proposed 2530 rule.

*HUD Response:* HUD understood the concerns made by these commenters about the need for further elaboration on various aspects of the rule, and it was these concerns that prompted HUD to issue the Supplemental Notice of Proposed Rulemaking through which HUD proposed to supplement the previous participation regulations with a Processing Guide. The Processing Guide would serve as a primary resource and provide the specificity for the procedural requirements governing the previous participation review process. HUD solicited public comment on this Processing Guide. As noted in Section IV, HUD is adopting the Processing Guide as part of the final rule changes. With the Processing Guide, HUD believes it has achieved the appropriate balance between specificity and flexibility. Comments on the Processing Guide and HUD's responses to these comments are provided in Section V.B. of this preamble.

*Comment: Method of filing.* Several commenters asked whether a participant's ability to file would be done electronically or would paper forms have to be used.

*HUD Response:* The regulations do not require filing electronically or paper filing. Both formats remain available, but HUD encourages electronic filing.

*Comment: Clarify that existing regulations are replaced in entirety.* A commenter asked that HUD clarify that the new regulations replace the existing regulations in their entirety. The

commenter stated that while the proposed rule clearly stated this, it was not repeated in the regulatory text.

*HUD Response:* The regulatory text does not need to specify that it is superseding previous regulations. The final regulations will replace the existing regulations in their entirety, and the existing regulations will then no longer be contained in the Code of Federal Regulations.

*Comment: Clarify whether a single purpose entity wholly owned by a public housing agency (PHA) is exempt from the previous participation process.* A commenter stated that it was not clear from the proposed rule if any single purpose entity wholly owned by a public housing agency (PHA) is still excluded from previous participation. The commenter asked for HUD to clarify.

*HUD Response:* Yes, entities that are wholly owned by a PHA are considered public housing agencies. For the commenter's reference, see HUD's regulation at 24 CFR 5.100, which defines "Public Housing Agency" to include "or instrumentality of these entities." Further, HUD's Office of Public and Indian Housing (PIH) issued PIH Notice 2007-15,<sup>6</sup> which defines "instrumentality" as "an entity related to the PHA whose assets, operations, and management are legally and effectively controlled by the PHA." The notice further states that "For the Department's purposes, an Instrumentality assumes the role of the PHA and is the PHA under the public housing requirements for purposes of implementing public housing development activities and programs."

*Comment: Address "flags" in regulatory text.* A commenter stated that HUD, in the preamble to the proposed rule, is absolutely correct in stating that use of flags under the current system has created serious obstacles to participation in HUD programs, even when such flags are not indicative of real risk. The commenter stated that if HUD is going to continue its practice of issuing "2530 flags," this policy should be clearly explained in the regulations. Other commenters similarly stated that, in many instances, program participants do not receive prior notice of flags; they do not know why they've been "flagged;" they do not know whether they can "appeal" the flags; and/or they don't know how to get flags removed or "resolved."

<sup>6</sup> See PIH Notice 2007-15 on "Applicability of Public Housing Development Requirements to Transactions between Public Housing Agencies and their Related Affiliates and Instrumentalities," issued on June 20, 2007, at [https://portal.hud.gov/hudportal/documents/huddoc?id=DOC\\_9278.pdf](https://portal.hud.gov/hudportal/documents/huddoc?id=DOC_9278.pdf).

*HUD Response:* HUD agrees that prior dealings with "flags" have been frustrating for all parties. HUD, however, does not agree that the level of detail asked by the commenters is appropriate for regulations. The role of flags in the previous participation process is one of the reasons that HUD has proposed the Processing Guide. The Processing Guide is the better vehicle to address flags and HUD did in fact address flags in the Processing Guide, published for comment on May 17, 2016. HUD provides additional comments received on flags and HUD's responses to these comments on Section V.B. of this preamble.

*Comment: Have one 2530 form, not multiple forms.* Commenters expressed opposition to HUD's intention, as they stated was presented in the preamble to the proposed rule, to allow the development of multiple previous participation forms specifically tailored to particular HUD programs. The commenters stated that multiple forms will only further complicate a process that HUD itself recognizes is overly burdensome and time-consuming. The commenters also stated that the existing 2530 form at least provides applicants the following: (i) Assurance that there is one consistent form for participation in all HUD programs, and (ii) guidance on what information must be provided and updated (in the Schedule A attached to the existing 2530 form) regarding prior participation in HUD projects (status of HUD loan, current Real Estate Assessment Center (REAC) score, etc.).

*HUD Response:* HUD is not proposing new previous participation forms at this time. In the preamble to the proposed rule, HUD simply noted that through the revised previous participation review process that HUD proposed in the August 10, 2015, rule, HUD may determine that 2530 forms more tailored to HUD-specific forms, rather than an across-the-board form, may be more appropriate, helpful, and facilitate the processing of a specific HUD transaction. For example, the structure of a Multifamily Housing transaction is vastly different from that of a Healthcare transaction or a Hospital transaction. It is not intuitive to fit a healthcare transaction's operator into the 2530 form used for a Multifamily Housing transaction. HUD's Office of Residential Care Facilities (ORCF) has advised that many submissions of the Form 2530 in connection with Healthcare transactions are completed incorrectly and do not yield adequate information to promptly process the healthcare transaction. For this reason, in its 2013 PRA information collection, ORCF developed as part of its consolidated certification, more

targeted questions that are easier to understand and fit more easily with a Healthcare transaction.<sup>7</sup> Since the existing regulations require the submission of the specific Form 2530, ORCF has been using both the current Form 2530, which does not reflect a healthcare transaction, and its improved Consolidated Certification. With these revised previous participation regulations, ORCF now has the ability, if it so chooses, to require only the more targeted and accurate disclosures and more complete certifications of the Consolidated Certification. Time will tell whether other programs, such as the Rental Assistance Demonstration program or the HUD Hospitals program, will consider submitting similarly tailored forms through the PRA process. The 242 program is currently in the process of document reform and is not proposing a change from the 2530 form at this time, but may do so in the future.

Whether HUD chooses to develop 2530 forms tailored for specific HUD transactions, the public should keep in mind that changes to the existing 2530 form or development of new previous participation forms must undergo the notice and comment process (a minimum of 90 days) required by the Paperwork Reduction Act (PRA).

*Comment: Exclude limited liability investors.* Commenters stated that the final rule should clarify that limited liability corporate investor (“LLCI”) certification is no longer required of low-income housing tax credit (LIHTC) investors or any other passive investors. Another commenter stated that it supports expanding the exemption given to LIHTC investors to all passive investors in other tax credit programs, such as the New Markets Tax Credit.

*HUD Response:* HUD believes 24 CFR 200.216(c)(1) is clear that passive investors are not Controlling Participants, and are not required to undergo previous participation review. However, HUD reserves the right to perform appropriate due diligence review of investors, including reviewing their financial capacity and understanding the organizational structure of proposed entities.

## 2. Comments on the Proposed Rule Regulatory Text

### Definitions (§ 202.212)

*Comment: Define Key Principal.* Commenters stated that the term “Key Principal” is a widely used term in the Active Partners Performance System

(APPS) but is not included in the regulations, and should be.

*HUD Response:* The term “key principal” continues to be used for underwriting purposes. HUD believes that the term “key principal” has been confusing in past practice with respect to previous participation review and has determined that the new terms Specified Capacity and Controlling Participant are more appropriate for previous participation review purposes. The APPS system will be updated to ensure consistency between the APPS system and the previous participation regulations.

*Comment: Distinguish between applicant entities and those that control them.* Commenters stated that HUD should use separate terms for the applicant entities requiring approval and those individuals and entities that control them.

*HUD Response:* HUD has added the term “Specified Capacity” and revised the definition of “Controlling Participant” to include the listed “Specified Capacities” and those entities and individuals that control the Specified Capacities. In addition, the Processing Guide elaborates on specified capacity and provides a chart that shows the specified capacities for the listed programs. See the Processing Guide, published for comment on May 17, 2016, at 81 FR 30497.

*Comment: Define Risk.* Commenters stated that the proposed rule does not adequately define “risk” or how HUD will evaluate risk.

*HUD Response:* In response to these commenters, HUD proposed in the Supplemental Notice, published on May 17, 2016, to include a definition of “risk” in § 200.212, that would clarify that in order to determine whether a Controlling Participant’s participation in a project would constitute an unacceptable risk, the FHA Commissioner must determine whether the Controlling Participant could be expected to participate in the Covered Project (as defined in the August 10, 2015, proposed rule) in a manner consistent with furthering HUD’s purposes. The proposed definition of “risk” and comments received on this definition and HUD’s responses are addressed in Section V.B. below.

*Comment: Clarify programs covered by previous participation review.* A commenter stated that there appears to be in the rule an inconsistency in the definition of previous participation. The commenter stated that specifically in § 200.212 the term is described as participation in Federal programs only, but the first paragraph of the Background section in the preamble to

the proposed rule suggests that participation in State and local government financed or assisted programs must also undergo the previous participation review process. Commenters stated that currently many participants disclose only their participation in HUD programs, which the commenters stated should be HUD’s concern. The commenters further stated that the assessment of risk by HUD of State and local participation greatly delays the clearance process since it requires HUD staff to track down the appropriate State or local officials who may have absolutely no interest in the 2530 process and therefore may not be inclined to cooperate.

*HUD Response:* The definition of risk, as proposed in the Supplemental Notice, clarifies this issue. The commenters are correct that HUD’s primary concern is previous participation in HUD programs. Previous participation in HUD programs is most relevant to HUD and HUD regards the information received with regard to previous participation in HUD programs (as opposed to other Federal, State or local programs) to be the most complete and most reliable because the information should correspond with HUD’s records. However, previous participation in other Federal, State or local programs may also be relevant to the evaluation of risk, and therefore HUD reserves the right to request this information when it is relevant and can be gathered reliably. It is possible that such information may prove valuable when evaluating the risk of a flag in the context of a Controlling Participant’s performance relative to their overall portfolio, especially if participation in HUD programs is minor compared with participation in other programs.

In this final rule, the regulations have been revised to clarify that previous participation must include HUD programs but that the FHA Commissioner may request and consider previous participation in any Federal, State or local government program if the Commissioner determines that such information is reliably available and necessary in evaluating financial or operational risk. Further, the Commissioner may exclude any previous participation from the previous participation review process if the Commissioner determines that such information is not relevant or cannot be reliably gathered. This regulatory structure allows greater specificity to be set forth in forthcoming guidance and to evolve as housing programs and risks evolve. HUD notes that in order to request any such previous participation information, HUD must follow the PRA

<sup>7</sup> See ORCF’s notice announcing final approval of HUD’s Healthcare Facility documents published in the *Federal Register* on March 14, 2013, at 78 FR 16279. See especially page 16281, third column.

process for information collection. The form 2530 already requires limited disclosure of State and local housing programs; the form requires Schedule A disclosures to list “every project assisted . . . by . . . State and local government housing finance agencies . . .”

#### Covered Projects (§ 200.214(d), (e))

*Comment: Covered projects subject to use restrictions should be limited to those administered by HUD’s Office of Housing.* Commenters stated that the category established by § 200.214(d), relating to projects with affordability restrictions, should be limited to projects whose use restrictions are administered by HUD’s Office of Housing.

*HUD Response:* These regulations govern only projects administered by HUD’s Office of Housing. For clarity, HUD has accepted the commenters’ suggestion to revise the language and add the phrase “administered by HUD’s Office of Housing.”

*Comment: Exclude project-based vouchers (PBVs) administered by HUD’s Office of Public and Indian Housing.* Commenters asked that HUD exclude from previous participation review projects with project-based voucher contracts.

*HUD Response:* The proposed regulations exclude PBVs, and this final rule retains that exclusion. See the exclusion in § 200.214(e)(3) of projects authorized by “section 8(o)(13) of the United States Housing Act of 1937 (42 U.S.C. 1437f(o)(13),” which pertains to PBVs.

*Comment: Do not exclude PBVs.* In contrast to the preceding comment, a commenter stated that projects participating in the Rental Assistance Demonstration (RAD) and receiving PBVs are not required to obtain previous participation clearance for a change in ownership or management agent but would be under the Project-Base Rental Assistance program administered by the HUD Office of Housing. Commenter suggested projects in the PBV program should be subject to previous participation review.

*HUD Response:* These regulations do not govern programs administered by the Office of Public and Indian Housing. There are several differences between the PBV and PBRA programs, which accomplish different policy goals and allow for various effects.

#### Controlling Participant (§ 200.216)

Many commenters stated that the definition of “Controlling Participant” in the proposed rule was too broad and needed further clarity and specificity.

Commenters offered suggestions on how Controlling Participant should be defined. Their suggestions are as follows:

*Comment: Limit and list specifically the individuals required to undergo previous participation review.*

Commenters stated that if HUD intends to include officers and directors, and individuals with authority to bind the entity as Controlling Participants, HUD should specify the parties required to file.

*HUD Response:* HUD submits that the more appropriate document for listing the entities and individuals that HUD determined are Controlling Participants is in the Processing Guide that HUD published on May 17, 2016. That list of entities that HUD determined are Controlling Participants and those that HUD determined are not Controlling Participants can be found in the Guide at 81 FR 30498. HUD reminds the public that the Processing Guide is subject to advance notice and opportunity for comment for any substantive changes.

*Comment: Replace “authority to bind” phrase (§ 200.216(b)).* Commenters objected to proposed § 200.216(b) inclusion of individuals with the “ability to bind” such entity with respect to Triggering Events. Other commenters suggested replacing this phrase with the phrase “ability to direct the entity in entering into agreements.”

*HUD response:* HUD has revised this provision with the commenters’ suggested language.

*Comment: Define “Influence.”* Commenters stated that § 200.216(c)(2) introduces the new concept of “influence” but HUD has not previously defined or given any direction on what this term means. The commenters requested that HUD define or remove this term. Another commenter suggested using the language “the ability to direct day-to-day operations or policy of a Covered Project.”

*HUD Response:* HUD has revised § 200.216(c)(2) to be consistent with the terminology used elsewhere in the rule. HUD has also revised § 200.216(b) to focus on those with control over “day-to-day operations.”

*Comment: How many “tiers” are included?* Commenters asked how many “tiers” within a given entity may be deemed to include “Controlling Participants.”

*HUD Response:* HUD is interested in reviewing the previous participation of the entities and individuals in control of a project, no matter how many “tiers” of entities are structured in between. HUD expects Controlling Participants to include at least one natural person. However, HUD is not interested in

receiving superfluous filings of several tiers of shell entities in an entity’s organizational structure. Shell entities that do not exercise control are excluded from filing requirements. This difference is reflected in the regulations and further clarified in the Processing Guide.

*Comment: Do not define control as a percentage of ownership.* Commenters stated that the language in § 2001.216(c)(2) meant to allow for exclusions limiting the scope of the review is undermined by the language defining “control” in § 2001.216(b) as a certain percentage of ownership. Commenter suggested revisions to this section to separate the exclusion language and eliminate the reference to percentage ownership.

*HUD Response:* HUD agrees in part and has revised this language. HUD has revised this language so that percentage ownership does not “define” control. Because other commenters have asked for greater clarity, HUD has retained the 25 percent ownership as an indicator of control. Participants should expect to undergo previous participation review if they own 25 percent of a Specified Capacity or a Controlling Participant. However, HUD has further revised this section to limit this 25 percent threshold by inserting the phrase “unless otherwise determined by HUD.” In other words, although having a 25 percent interest creates a presumption that a person or entity exercises control, HUD may make a determination otherwise if given other evidence indicating that the person or entity that owns the 25 percent share does not actually exercise control. The Processing Guide provides further clarity on this matter. This is now consistent with the limitation in the revised § 2001.216(c)(2), excluding entities and individuals not exercising control.

*Comment: Percentage of ownership is an outdated way to determine ownership.* Similar to the immediately preceding comment, a commenter stated that the concept of 25 percent or more ownership is an outdated notion of how modern organizations are structured and controlled. The commenters stated that investor entities have no rights to current control of entities, despite owning a majority of the interests. The commenters stated that HUD’s focus should be not on who owns how much, but ultimately on who controls what (financially or operationally).

*HUD Response:* HUD agrees in part with the commenters. As HUD noted above, HUD has revised the regulations to separate percentage interest from the definition of control. However, except

in the case of tax credit and other passive investors, HUD notes that in the majority of organizational structures, ownership of 25 percent or more of the ownership interests is a good indicator of control. Therefore, in response to other comments seeking greater clarity, HUD has retained this indicator but revised the language to indicate that HUD may make a determination that the person or entity does not exercise control, if there is a basis for such determination. Further, HUD notes that tax credit and passive investors are specifically excluded from review.

*Comment: Exemption of PHA from definition of Controlling Participant is not appropriate.* A commenter stated that the exclusion of PHAs in § 200.216(c)(4) is overly broad.

*HUD Response:* PHAs are public entities that are overseen by HUD. HUD has determined that HUD has other methods of monitoring PHAs and that previous participation review is unnecessary given HUD's other oversight over PHAs.

*Comment: Specify Controlling Participants for nonprofit entities, real estate investment trusts (REITs) and public companies.* Commenters stated that the regulations should specifically identify who is subject to previous participation review for nonprofit corporations, REITs, and public companies. The commenters stated that there can be significant differences in how "control" is held in each of these types of corporations, and that these differences have been the subject of much confusion over the years, by HUD staff and industry members alike. Another commenter stated that § 200.216(a)(7), which speaks to hospital Boards of Directors, leaves unclear how HUD intends to treat Boards of Directors in the non-hospital context, as the proposed rule is silent on this matter.

*HUD Response:* With respect to hospitals under the Section 242 program, it is reasonable for the regulations to specifically address members of the hospital's board of directors because it is the typical structure for projects in the hospital program to have a nonprofit board of directors in a way that is not true for the variable organizational possibilities in other programs. However, HUD agrees with the commenters that confusion has arisen in recent years with regard to nonprofit entities, REITs and public companies. HUD agrees that the reference to hospital nonprofit entities without clarifying the approach for other nonprofit organizations may increase this confusion.

In response to these comments, HUD has revised the language to clarify that

unless members of a nonprofit board of directors are exercising day-to-day control over a Specified Capacity or a Covered Project, they need not submit for previous participation review. HUD does not believe the same clarity can be achieved through regulation with respect to REITs or public companies, nor does HUD believe that any regulation can keep pace with the ever-changing corporate organizational conventions. Therefore, HUD clarifies in the Processing Guide the requirements for REITs and public companies. The Processing Guide allows HUD to adhere to the concept expressed in the regulations that those individuals and entities that exercise control over a Specified Capacity and Covered Project are subject to previous participation review.

*Comment: Explicitly exclude certain entities.* Commenters stated that the following should be explicitly excluded from review:

- Any passive investor (e.g., limited partner), regardless of whether the funding involves tax credits, provided that the entity is not on the General Service Administration's (GSA) most recently published list of parties debarred, suspended or disqualified by federal agencies (the "GSA List");
- Any publicly-traded corporation, REIT, or other entity that is listed on any exchange regularly reported in the Wall Street Journal, provided that such entity is not on the GSA List; and
- Any entity subject to regulatory oversight by the Securities Exchange Commission (SEC), the Federal Trade Commission (FTC), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC) and/or the Federal Reserve Board (FRB), provided that such entity is not on the GSA List.
- Directors of nonprofit boards, including PHA boards, who have no day-to-day responsibility or authority. Commenters stated that PHA and nonprofit boards typically consist of volunteers, and for PHAs, often at least one public housing resident.

*HUD Response:* These concerns have already been largely addressed by HUD's exclusion of passive investors, publicly traded companies and nonprofit entities. Although HUD does not believe that its previous participation regulations should categorically exclude entities overseen by other Federal regulatory entities (whose oversight may not adequately account for HUD programs and whose standards for oversight may change), HUD is nevertheless open to further considering (on a case-by-case basis, or perhaps in future issuances on the

previous participation review process) that the review sought by the regulations is achieved through the oversight conducted by these other entities.

*Comment: Require an entity's attorneys to certify as to who the controlling participants of the entity are.* A commenter suggested that in order to increase the efficiency and accuracy of HUD's determination as to the individual who exercises operational or financial control over an entity, HUD should require the entity's attorneys to certify as to who such individuals are.

*HUD Response:* Although HUD does not believe that this process is appropriate for regulation and HUD is not imposing this requirement at this time, an attorney certification may be a valuable tool for determining control and HUD is open to further discussions and consideration on this topic in the future.

*Comment: Suggestions for limited liability companies (LLCs), limited partnerships (LPs), nonprofit entities, REITs and management companies.* Commenters made several suggestions regarding LLCs, LPs, nonprofit entities, REITs and management companies that to some extent overlap with and to some extent vary from the comments summarized above. A commenter asserted that variations from standard ownership structures rarely occur and that the following individuals be identified for review: Managing members of LLCs and the person with controlling stock in the LLC; the person with control of 51 percent or more general partner of a LP; the person who controls 51 percent or more of the parent entity of a REIT or the person who voted in public filings; and the individual or entity owning 51 percent or more of the management company. The commenter stated that nonprofit entities will likely "follow the same rules as LLCs or general partnerships," but does not explain what this means or how to apply the rules for LLCs or general partnerships to a nonprofit corporation (that does not typically have owners, majority members or partners).

*HUD Response:* HUD appreciates the suggestions and the Processing Guide addresses these concerns. This comment also illustrates the difficulty that HUD faces with leaving only to regulations to address a changing lending market, and changing structures of lending/financial institutions. Although most organizational structures may align along certain conventions, variations are not infrequent. HUD needs regulations that are sufficiently flexible to be used in all scenarios—or at least all but those very few worthy of a waiver. This is not

only impossible but, in fact, probable that if HUD sets up overly detailed regulations based on contemporary organizational structures, corporate practice will be able to easily side-step the rule. To illustrate, consider that no person owns 51 percent or more of a company and two business partners each owns 49 percent of a company and a third owns 2 percent. The question therefore arises as to whether no partner should be identified for previous participation review. HUD believes that the commenter does not mean to suggest that no one controls an entity if they do not own 51 percent of that entity. Indeed, the 25 percent ownership, long-established as a threshold for control for HUD's purposes, has been side-stepped on a number of occasions by complicated organizational structures that appear to limit any individual's control to 24 percent or less or obscure related interests. It is exactly for this reason that HUD believes the best place for this level of detail is in the Processing Guide, rather than in the regulations themselves, and again HUD reminds its prospective participants that the Guide will be subject to advance notice and public comment if substantive changes are made.

*Comment: Clarify how HUD will determine control of finances or operational decisions.* Commenters stated that in § 200.216(b), HUD did not clarify how it would determine whether an individual participating actually controls the financing or operational decisions of the participant. Another commenter stated that proposed § 200.216(a)(7) does not clarify how HUD proposes to determine whether the hospital Board of Directors and its executive management have control over the finances or operation of a Covered Project.

*HUD Response:* The Processing Guide addresses the commenters' concerns. Again, HUD anticipates that as corporate conventions evolve, who controls an organization may change. HUD does not seek to lock onto the corporate structures of today but rather establish a framework under which those who control a Covered Project receive adequate review.

*Comment: Remove reference to general contractor.* Commenters stated that, in § 200.216(a)(6), reference to management agents and general contractors lacks clarity.

*HUD Response:* The Processing Guide elaborates on these terms.

*Comment: Provide Controlling Participant opportunity to appeal any adverse decision against the Controlling Participant:* Commenters stated that the final rule should allow the Controlling

Participant an opportunity to appear in person before the committee/officer to present its documents/arguments. Another commenter stated that it is essential that Controlling Participants have a right to appeal, and that HUD should inform the applicant of how to appeal in its notice informing the participant of the disapproved, limited or conditional approval. The commenter stated that the notice should include procedures for the appeal, identify to whom the appeal should be directed, and specify the information to submit with the appeal. The commenter further stated that HUD should also be required to acknowledge the appeal and make a determination within 30 days of receipt, which is the same timeframe to file an appeal provided for the Controlling Participant.

*HUD Response:* HUD does not believe an in-person appearance is necessary. Given the changing nature of the workplace and increasing technology, HUD submits that it is not necessary for everyone providing input on a reconsideration of a determination to be physically in the same room. In addition, just as the changing nature of corporate structures may affect who a Controlling Participant is under future corporate conventions, it is not clear that one structure for seeking reconsideration of a HUD determination will be appropriate in perpetuity. As HUD offices and positions change, the person/persons responsible for reconsideration requests may also change. HUD agrees with the commenters that an opportunity for reconsideration is essential and has structured the final rule accordingly. The final regulations make clear that applicants will be given advance written notice of the reconsideration and an opportunity to submit supporting materials. This means that the matter will not be reconsidered prior to the date provided so that any arguments and materials provided by the participant can be considered. In response to these and similar comments, the final rule specifies that notice of reconsideration shall provide at least 7-days advance notice, which is meant to provide a meaningful opportunity for the submitter to provide supporting materials. HUD has also included in the Processing Guide that HUD will send the required notice of reconsideration no later than 30 days after receipt of the request for reconsideration.

Triggering Events (§ 200.218)

*Comment: Avoid duplication of review.* A commenter stated that in § 200.218(f), HUD provides only one opportunity to avoid duplication of

review, under "sale of a HUD Held Mortgage" but urged HUD to consider other circumstances under which HUD might avoid duplicative review. The commenter stated that the industry feels there is significant duplicative review for "well-known established institutional entity already familiar to HUD." Identifying additional opportunities to avoid duplicative review would alleviate burden for industry partners and HUD staff alike.

*HUD Response:* HUD believes that the exclusion of non-controlling members and the other exclusions set forth in the Processing Guide help to reduce duplication of review. HUD is interested in continuing conversations with the industry to identify additional ways to reduce duplication and welcomes additional suggestions.

*Comment: Do not make 2530 process applicable to note sale bidder.* A commenter stated that § 200.218(e) makes the 2530 process applicable to a mortgage note sale bidder. The commenter stated that such entities are looking to purchase the note/operate the project outside of the HUD system and HUD risk factors in that instance appear to be irrelevant where HUD will no longer have involvement with the note or the asset. The commenter stated that in the event there may occur something like a housing assistance payment (HAP) assignment down the road, the clearance for that purpose can be handled at that time.

*HUD Response:* HUD agrees in part and has revised § 200.218 in response to this comment. HUD notes that note sale bidders and bidders in foreclosure sales have been and will continue to be vetted by HUD. However, note sale bidders have not been required to complete a full-previous participation submission as part of this vetting. In contrast, bidders at foreclosure sales or other forms of property disposition are often required to operate the projects with continued use restrictions administered by the Office of Housing and thus in many instances have been required to undergo previous participation review. Due in part to the variable circumstances surrounding such sales, and because the statutory and regulatory authorities governing note sales and property dispositions provide broad discretion for HUD to set the requirements for such sales, the requirements are set forth in instructions commonly referred to as the "Bidder Qualification Statement" or "bid kit." HUD has revised the regulations to clarify that the requirements for note sales and property dispositions continue to remain governed by their program

requirements, including without limitation the requirements set forth in the Bidder Qualification Statement or other instructions. These documents may require some vetting of previous participation of applicants, but depending on the individual circumstances and the time pressures associated with such sales, the Bidder Qualification Statement or other instructions may dictate modifications to the process, including for example, a shortening of the period to request a reconsideration. The final regulations continue to allow HUD to require through the note sale and foreclosure sale bidder qualification requirements, appropriate vetting of bidders in accordance with the relevant statutory and regulatory authorities.

*Comment: Limit application of funds to those administered by the Office of Housing.* A commenter suggested limiting the language in § 200.218(b) relating to “[a]n application for funds provided by HUD, such as but not limited to supplemental loans or flexible subsidy loans” to such funds providing pursuant to a program administered by HUD’s Office of Housing. Another commenter similarly suggested limiting this triggering event to an application for funds in HUD multifamily programs.

*HUD Response:* It is HUD’s intention to limit these regulations to those programs administered by HUD’s Office of Housing, and this final rule reflects this limitation.

#### Previous Participation Review (§ 200.220)

*Comment: Clarify scope of review.* Commenters stated that HUD’s proposed rule indicates that the FHA Commissioner’s previous participation review “shall include previous financial and operational performance in federal programs that may indicate a financial or operating risk . . . ;” and that the Commissioner “shall consider financial stability; previous performance in accordance with [HUD requirements]; general business practices and other factors . . . .” The commenters stated that if HUD is truly committed to ensuring that the 2530 process does not become even more burdensome and overly inclusive the 2530 review should be limited to evaluating the Controlling Participant’s performance as it relates solely to the information required on the 2530 form for the Controlling Participant’s Covered Projects.

*HUD Response:* HUD agrees in part and the definition of risk that has been added at this final rule stage addresses these comments. However, regardless of the regulations, HUD is limited to

collecting the information for which it has PRA approval. If HUD wishes to change the form 2530 or ask for additional information, it must complete the PRA process, including the requirement for public comment, for a new form.

*Comment: Provide standards for disapproval.* A commenter stated that the scope of review needs some specific details/clarification and that HUD should consider addressing standards for disapproval.

*HUD Response:* The standards for disapproval remain the same as they have always been: An unacceptable risk to HUD. In response to this comment and similar other comments, HUD has revised the language in § 200.220 and separated out a more focused definition of risk to clarify the scope of review.

*Comment: Distinguish between prior ownership and current ownership.* Commenters stated that organizations that purchase distressed HUD properties for the purpose of stabilizing and improving them have periodically gotten hung up by flags that relate to the actions and omissions of prior owners from whom the properties were purchased. Commenters stated that HUD needs to improve its systems for recognizing and distinguishing between issues related to prior ownership and issues of current owners.

*HUD Response:* HUD appreciates this comment and the commenter’s raising awareness on this issue. In response to these comments and comments received on the Processing Guide, the Processing Guide has been revised to elaborate on these issues. HUD continues to work on standardizing asset management practice and improving all aspects of the previous participation review. HUD acknowledges that there has been inconsistency and unintended consequences in the past. However, flags are issued to ownership entities, not to properties. Flags are not to be issued to new owners for violations of a prior owner. If this has happened, it is in error and the owner should contact the appropriate HUD office to resolve the flag.

*Comment: Define general business practices and other factors.* A commenter stated that proposed § 200.220(a)(1) states that the Commissioner’s review shall consider undefined “general business practices and other factors” in determining whether a Controlling Participant is expected to operate a Covered Project in a manner consistent with HUD’s purposes. The commenter stated that this term needs to be defined.

*HUD Response:* As provided in response to similar comments, the final

rule includes a more focused definition of risk and has eliminated this “general business practices” language. Further, HUD reiterates that any information HUD collects in connection with the previous participation review is subject to the PRA and the PRA process, giving the public an opportunity for comment.

*Comment: Identify risk factors and define impermissible risk.* A commenter stated that current regulations include a section titled “Content of Certifications” which indicates a portion of the risk elements that HUD will review, but that the proposed rule does not include this detail and is relatively silent on the exact nature of HUD’s expectations regarding what constitutes Impermissible Risk.

*HUD Response:* HUD’s more focused definition of risk addresses the commenter’s concern.

*Comment: Have the review include reviews of credit history.* Commenters stated that the proposed rule would have authorized HUD to take into account “mortgage defaults, assignments, or foreclosures” [not limited to HUD direct loans or FHA-insured loans] and “instances of noncompliance with the regulations, programmatic or contractual requirements of HUD.” The commenters stated that recently some of its members have observed sales of HUD-assisted properties at prices that are above their own estimates of long-term economic viability, sometimes to investors with little experience in real estate or assisted property management, and that some of these same properties subsequently are found out of programmatic compliance due to insufficient funding for rehabilitation, maintenance, or deposits to replacement reserves. The commenters stated while they do not support deeper review of proposed transaction terms, they urge that HUD conduct consistent reviews on credit history and past programmatic compliance (when available) to better guard against purchasers with a record of default or failure to meet rehabilitation and maintenance requirements (if HUD is not otherwise conducting a Transfer of Physical Assets (TPA), assignment of the HAP contract, or other review).

*HUD Response:* These previous performance regulations address the disclosure of deficiencies in past performance; they are not the vehicle for highlighting the absence of sufficient relevant experience. Disclosure of overall experience and capacity is addressed in other elements of applications related to a particular triggering event. HUD continues to make improvements in its various application



processes, and welcomes suggestions for further improvements in that respect.

*Comment: Clarify “extent requested by HUD.”* A commenter stated that the language in § 200.220(a)(3) “to the extent requested by HUD” is too broad and open-ended. HUD needs to clarify their requirements.

*HUD Response:* “To the extent requested by HUD” refers to the information requested on PRA-authorized forms, such as the Form 2530.

*Comment: Clarify meaning of “limit” or “otherwise condition” approval.* Commenters stated that in § 200.220(b)(1) HUD must clarify what it means to “limit” or “otherwise condition” approval for the Controlling Participant to continue to participate in a Covered Project. The commenters stated that such limits and/or conditional approvals should specify the time limits associated with each alternative. The commenters stated that in § 200.220(d)(1) HUD should define what it means to “condition” or “limit” approval and also specify the time period for such actions. The commenters stated that such time periods should be reasonably related to the rationale for such a determination, and clearly articulated by HUD.

*HUD Response:* The concept of conditional or limited approval is an accommodation on HUD’s part to provide a middle ground between disapproval and approval. Whereas current practice withholds approval until all “flags” are lifted, conditional approval is intended to clarify the path forward. HUD’s intention is to provide the conditions necessary for approval in such circumstances. The regulations cannot contemplate all potential scenarios for limited or conditional approval. The revised Processing Guide elaborates on this concept.

*Comment: Provide timing for identification of a Controlling Participant when a Triggering Event occurs.* Commenters stated that where proposed § 200.220(a)(3) requires that an applicant in connection with a Triggering Event “shall identify the Controlling Participants,” HUD should provide greater clarity regarding the timing of HUD’s determination and the basis for that determination. The commenters stated that it would be more efficient and provide greater predictability for applicants if HUD would clearly identify who, at a minimum, are the “Controlling Participants” of a project, such as the general partner of a limited partnership and the managing member and managers of a limited liability company.

*HUD Response:* The Processing Guide addresses the commenters’ concerns.

*Comment: Specify time for HUD to conclude previous participation review, and provide notification of conclusion of review.* Commenters stated that at proposed § 200.220(b)(2) HUD does not specify the timeframe in which HUD shall provide notice of a previous participation determination. The commenters stated that HUD should provide such notice within 14 calendar days of reaching such a determination. The commenters further stated that the proposed rule does not specify which other parties, aside from the FHA-approved lender in the transaction, may receive notice of a previous participation determination from HUD. The commenters stated that presumably only those parties actually involved in the transaction at issue should be notified, and, if this is correct, HUD should clarify this in its rule. The commenters further stated that HUD should be mindful of concerns about privacy and disclosure of trade secrets as well as releases of information that may be pre-decisional and prejudicial, particularly because HUD’s determination may not necessarily be based on a complete record if the Controlling Participant has yet to appeal HUD’s decision and present additional evidence and HUD has not adequately weighed such additional material.

*HUD Response:* HUD is not aware of problems in providing notification to parties after a determination has been made and believes current practice is providing timely notice. However, it is difficult to determine how long it will take HUD to make a determination in any particular transaction because the facts of each transaction, and therefore the review necessary, vary so widely. HUD is mindful of privacy and other concerns and continues to be held bound by such limitations on its authority and practice. Except to the extent that HUD is an agency of the Federal government and individuals’ expectations for privacy are limited among Federal government actors once information is disclosed to the federal government, HUD does not foresee sharing information on determinations with parties not involved with a transaction or their agents.

*Comment: Clarify what is meant by “any federal program.”* Commenters stated that the reference to “any federal program” should be clarified because it is unclear which programs HUD intends to cover. Commenters stated that currently, there is much confusion regarding HOME Investment Partnerships (HOME) program, the Community Development Block Grant

(CDBG) program, LIHTC and other programs that may be essentially a pass-thru of Federal funds via a State or local jurisdiction. The commenters asked whether it is HUD’s intent to review these properties as part of previous participation review and, if not, a clarification needs to be included.

A commenter stated that the reference to “federal programs” in the second sentence of § 200.220(a)(1) should be limited to the programs administered by HUD’s Multifamily Housing Office.

Another commenter stated that while previous performance in Federal programs is relevant for determination of risk, the proposed language allows for too detailed a review for the purposes of the regulations. The commenter specifically stated the language includes financial and operational performance in non-federal environments and general business practices. The commenter stated that § 200.220(a) should be changed as follows: “The Commissioner’s review of a Controlling Participant’s previous participation shall include previous financial and operational performance in federal programs that may indicate a financial or operating risk in approving the Controlling Participant’s participation in the subject Triggering Event. The Commissioner’s review shall consider previous performance in accordance with HUD statutes, regulations and program requirements; and other factors that indicate that the Controlling Participant could not be expected to operate the project in a manner consistent with furthering the HUD’s purposes.”

*HUD Response:* All HUD and other Federal funding come from a single source—the taxpayer. To the extent HUD has the capacity and capability of ascertaining and reviewing an applicant’s previous stewardship of any Federal funds, HUD intends to do so. However, HUD is limited in two important ways: (1) Such capabilities are currently limited; and (2) any additional information that HUD wishes to collect from applicants or other filers must complete the PRA process.

*Comment: Clarify what it means to be “restricted from doing business.”* Commenters stated that in § 200.220(c)(2)(i) HUD should clarify what it means to be “restricted” from doing business with any other department or agency of the federal government, because this term is undefined and could conceivably capture relatively minor limitations on a Controlling Participant’s activities. The commenter stated that this ambiguous basis for disapproval also fails to consider the nexus between the

restriction and the relevant HUD programs.

*HUD Response:* HUD agrees and the final rule reflects this change.

*Comment: Clarify what is a “record” of “significant risk.”* A commenter stated that in § 200.220(c)(2)(ii) HUD should clarify what constitutes a “record” of “significant risk” that would form the basis for disapproval, and that otherwise the regulation would be at risk of being found void for vagueness.

*HUD Response:* To address these and similar comments, HUD has included a more focused definition of risk in the final rule.

*Comment: Specify time for withholding previous participation determination.* Commenters stated that in § 200.220(d)(2) HUD should clarify how long it may temporarily withhold issuing a previous participation determination so as not to interfere with transactions or unnecessarily hinder the business decisions of prospective participants.

*HUD Response:* It is difficult to put a time limit on determinations because the facts of each transaction, and therefore the review necessary may vary so widely from one transaction to the next. HUD commits to reach a final decision as promptly as possible given the nature of the transaction and the documentation that HUD has received.

*Comment: Clarify scope of expected remedial measures.* A commenter stated that in § 200.220(d)(3) HUD should clarify the scope of expected remediation or remedial measures that Controlling Principals may be required to undertake. The commenter stated that the language in this section of “to the Commissioner’s satisfaction” is incredibly vague and open-ended and must be adequately defined. The commenter stated that if this phrase is not clarified Controlling Participants will not have adequate notice of the regulatory requirements they are expected to abide by.

*HUD Response:* The concept of remedial measures is an accommodation on HUD’s part to provide a middle ground between approval and disapproval. Any remedial measures must be targeted at reducing the risk posed by the subject Controlling Participant. The more focused definition of risk in the final rule and addresses the commenter’s concern and the Processing Guide elaborates on this concept.

*Comment: Limit look back at prior performance to 10 years.* Commenter stated that HUD should clarify that it is only reviewing Previous Participation for the past 10 years, which is the

current requirement per the HUD 2530 Form. The commenters stated that HUD has not specified how far back it will look when evaluating the previous participation record of Controlling Participants, and they stated that they saw no reason for HUD to depart from the ten (10) year period specified in the existing regulations.

*HUD Response:* The Processing Guide reflects that HUD is retaining the look-back period with respect to information gathering for 10 years. However, the Processing Guide notes that HUD reserves the right to review and consider a participant’s previous participation in a Federal project beyond the 10-year period when determining whether to approve participation in the project associated with an application. For example, as stated in the Processing Guide, Tier 1 flags reflect such a high degree of risk that HUD reserves the right to consider those violations, in the context of the Controlling Participant’s other participation, even beyond a 10-year period.

*Comment: Clarify obligation of Controlling Participant to file HUD Form 2530.* A commenter stated that HUD should clarify the obligation of a Controlling Participant to file the HUD form 2530 and reference the form in the regulations.

*HUD Response:* HUD has determined that it is inappropriate to reference a specific form in the regulations. As discussed earlier in this preamble, HUD wants to retain the flexibility to develop and authorize other forms, through the PRA process, if HUD determines another form or more tailored 2530 form is appropriate.

*Comment: Rule expands not reduces scope of review.* A commenter stated that § 200.220 expands HUD’s ability to increase the scope of the previous participation review by determining, on an ad hoc basis, what the HUD reviewer may deem a “significant risk” at any particular time. The commenter stated that the proposed rule does not clarify what “financial and operational performance” HUD would consider “a financial or operating risk.” The commenter stated that in order to avoid arbitrary or capricious determinations, HUD must provide more specific guidance on what is to be reviewed and how HUD will determine what is considered a “financial or operating risk” or a “significant risk.” The commenter stated that in the preamble to the proposed rule, HUD sets forth examples of unacceptible risks, which include those currently existing in § 200.230, such as: (1) Mortgage defaults, assignments or foreclosures; (2) suspension or termination of payments

under any HUD assistance contract; (3) significant work stoppages; and (4) instances of noncompliance with the regulations, programmatic or contractual requirements of HUD or a State or local government’s Housing Finance Agency in connection with an insured or assisted project. The commenter asked that the examples be incorporated into the regulatory text to provide additional clarity on the types of “significant risks” for which HUD will be reviewing.

*HUD Response:* HUD has addressed these concerns by including a more focused definition of risk in the final rule.

Request for Reconsideration (§ 200.222)

*Comment: Identify who serves on Review Committee.* Commenter stated that the proposed rule indicates that requests for reconsideration shall come before “. . . a review committee or reviewing officer . . . .” Commenters stated that the final rule should identify the title(s) of the persons that may serve on the review committee or as a reviewing officer; require participation by the Deputy Assistant Secretary for Multifamily Housing (the “DAS”) or the designee of the DAS, and expressly exclude from the committee/reviewing officer any HUD employee or official that was involved in rendering the initial disapproval or limited/conditioned approval.

*HUD Response:* HUD does not agree that specific titles or positions should be identified in the regulations, nor does HUD believe that reconsiderations should necessarily rise to the level of involvement by the DAS. Further, HUD does not believe that the individuals reviewing the initial applications should be wholly excluded from the reconsideration process, as they are the individuals in HUD with the greatest knowledge of the submission. However, HUD does agree that the submission should be reviewed and reconsidered by one individual. As a result, HUD has provided in the final rule that reconsideration decisions shall not be rendered by the same individual who rendered the initial decision.

*Comment: Specify time frame for reconsideration review.* Commenters stated that HUD should specify the timeframe in which the HUD review committee or reviewing officer shall schedule a review of any requests for reconsideration, because in the past there were no deadlines incumbent on HUD to resolve 2530 flags, which resulted in closing delays, delayed property improvements, and losses of tax credits and investment dollars in a number of cases. The commenters

recommended that HUD schedule such a review no later than 14 calendar days following receipt of a request for reconsideration.

*HUD Response:* As HUD noted in response to a similar comment, formalizing one reconsideration structure in perpetuity in the regulations is not a beneficial approach. However, HUD has provided in the Processing Guide that HUD will send the required notice of reconsideration no later than 30 days after receipt of the request for reconsideration.

*Comment: Impose time limit on review.* Commenters stated that in the interest of ensuring that decisions do not languish and resolution of open matters is achieved in a timely fashion, HUD should impose an upper time limit during which the review committee or reviewing officer may affirm, modify or reverse the initial decision. Commenters stated that a reasonable time frame would be 30 days following receipt of the Controlling Participant's submission of supplemental materials in support of reconsideration.

*HUD Response:* As HUD noted in response to a similar comment, it is difficult to put a time limit on reviews because information from transaction to transaction varies so widely.

#### *B. Comments on the Supplemental Notice of Proposed Rulemaking and Processing Guide*

##### 1. General Comments

Similar to comments that commenters made on the proposed rule, commenters commended HUD for the additional changes proposed in the Supplemental Notice and Processing Guide, but recommended further changes. A few commenters sought more specificity and clarity. The signature issues raised by the commenters are as follows:

*The Processing Guide provides or does not provide the specificity requested.* Several commenters supported HUD's approach to supplement the updated previous participation regulations with a guidance document. A commenter stated that the Processing Guide: (i) Includes details about the 2530 process; (ii) is referenced in the regulation; and (iii) is subject to public comment for significant changes. The commenter stated that as a precedent for this approach, HUD cites regulations that require publication in the **Federal Register** and a 30-day comment period for proposed changes to multifamily mortgage insurance premiums (MIPs). The commenter stated that it is familiar with this process, as well as HUD's Multifamily Accelerated Processing

(MAP) guide, which provides detailed instructions to lenders about the application, endorsement and closing processes for MAP loans. The commenter stated that, in its previous comment letter on the proposed rule, the commenter stated that it asserted that stakeholders must be able to find all 2530 policies in one place. The commenter stated that it previously commented that a reasonable person should be able to find everything they need to know about the previous participation review with minimal effort. The commenter stated that by referring to the Processing Guide in the actual regulation and including a mandatory notice and comment period for significant changes, HUD has satisfied the commenter's concerns.

In contrast to this commenter, a few commenters stated that the proposed Processing Guide needed additional detail and specificity. The commenters stated that the Processing Guide provide HUD too much discretion to identify Controlling Participants. The commenters stated that this lack of clarity adds complexity and significant time for both HUD staff and industry applicants in reviewing organization documents, evaluating the role of executive management positions and debating the issue of "control." The commenters asked that HUD re-issue the proposed rule and Processing Guide for additional public comment. Another commenter similarly stated that because the proposed regulations and Processing Guide are interdependent policy documents, and HUD should re-issue the proposed rule concurrently with the Processing Guide and provide the public with an additional 60-day opportunity to comment on the complete set of policies and procedures in order to provide greater transparency and commitment to the regulatory process.

*HUD Response:* HUD agrees with the commenters that additional detail can be included in the Processing Guide and has revised the Processing Guide in response to the specific issues identified in the comments submitted. The remainder of this section details the specific issues raised and HUD's responses. HUD declines to reissue the rule and Processing Guide for further public comment. However, HUD does not need to issue a formal call for public comment. HUD program participants are welcome at any time to propose changes to the rule, 2530 Form, and Processing Guide that they believe will improve the previous participation process and HUD will always consider such suggestions.

*Convene a meeting with industry before issuance of the final rule and*

*Processing Guide.* A commenter stated that it appreciated HUD tackling the 2530 process, but the commenter expressed concern with the discretion granted to HUD to make determinations and sought uniformity and standardization in implementing changes, especially with respect to the determination of who constitutes "controlling participants" and the placement and permanence of flags. The commenter urged HUD to convene a meeting as soon as possible with all interested parties to discuss concerns and further encouraged HUD to consider making additional revisions to the proposed regulations to address new concerns raised by comments to the Processing Guide. The commenter also cautioned HUD to ensure appropriate delegations of authority and coordination with the MAP Guide, RAD Notices, the APPS Guide and Closing Guide. The commenter urged HUD to consider how the revised Previous Participation policies and requirements will interact with existing HUD program requirements.

*HUD Response:* HUD agrees that uniformity and standardization are necessary in the implementation of these regulations and Processing Guide. To the extent such standardization can be assisted with greater clarity and specificity in the Processing Guide, HUD has attempted to revise the document accordingly. HUD has also coordinated revisions with policies in the MAP Guide and with HUD programs. HUD also agrees that implementation of the regulations and Processing Guide warrants meetings, discussions and trainings with both HUD staff and with interested outside parties. HUD notes that it has held numerous meetings over the past several years, as detailed in the Proposed Rule, seeking industry input. HUD has also participated in numerous conference panels and other discussions where industry concerns and opinions have been discussed. HUD does not believe that a meeting is necessary at this time to discuss additional comments to the regulations and Processing Guide. Interested parties have had numerous and sufficient opportunities, including through this regulatory process, to voice their concerns and explain their comments.

*Appropriate comment period for changes to Processing Guide.* A few commenters stated that HUD should provide a minimum period of 60 days for public comment on significant changes to the Processing Guide. Another commenter stated that it supported HUD's Processing Guide approach but that in the absence of a

definition of what constitutes a “significant” change, HUD should err on the side of transparency and disclosure.

*HUD Response:* HUD maintains the minimum comment period of 30 days as proposed in the May 17, 2016, Supplemental Notice of Proposed Rulemaking. A 30-day minimum comment period is the typical minimum comment period that HUD uses in other regulations, such as the change in premiums as provided in 24 CFR 207.254. HUD emphasizes that 30 days is the minimum period, and HUD has the discretion to increase the comment period if it determines a longer period would be beneficial.

*Establish a streamlining process for higher volume participants.* A commenter encouraged HUD to adopt a process that would allow a participant with a higher volume of HUD transactions and who has a strong track record of compliance and performance to submit a single annual report.

*HUD Response:* HUD finds this idea interesting but does not have the systems infrastructure to appropriately implement this idea at this time. Further, HUD believes the changes being made through these final regulations and Processing Guide provide a significant reduction in burden and create significant challenges in implementation independent of the additional changes the commenter requests.

*Provide specific guidance on HUD responsibility for review.* A commenter stated that inconsistent application and interpretation of requirements between different HUD offices in the previous participation review process has long been a concern. The commenter stated that HUD should provide detailed and specific guidance on timing and locus of responsibility for review and approval of initial applications and appeals. Another commenter urged HUD to provide contact information for the HUD staff contacts who are involved in the previous participation approval and reconsideration processes.

*HUD Response:* HUD agrees that standardization and uniformity are a goal in implementation. To the extent such standardization can be assisted with greater clarity and specificity in the Processing Guide, HUD has attempted to revise the document accordingly. HUD notes that the Processing Guide includes tables stating the specific roles within HUD that have the responsibility for approving participants with flags, disapproval of participants and reconsideration. The Processing Guide has also been revised to include a link to a Web site with

more specific contact information. HUD also notes that the Previous Participation review is only one, limited aspect of HUD review of applicants and transactions. Previous Participation review cannot substitute for underwriting and other HUD application reviews.

*Update MAP Guide.* A commenter requested that the MAP Guide be updated as soon as possible after the Previous Participation final rule is issued.

*HUD Response:* HUD believes the MAP Guide is consistent with these final regulations and Processing Guide. If commenters know of inconsistencies, they are always welcome to bring them to HUD’s attention.

*Importance of training for HUD staff.* A commenter stated that it recognizes that training for HUD staff on how to interpret and apply the new regulation and Processing Guide is important, and the commenter offered assistance with providing the training. The commenter stated that it appreciated the extensive work HUD has undertaken to update this regulation and some of the appropriate flexibility that is to be incorporated in HUD’s administration of the previous participation review.

*HUD Response:* HUD fully agrees with the commenter and HUD staff will undergo training to ensure they properly implement the new regulations.

#### B. Specific Comments

##### 2530 Form

*Retain the current 2530 Form.* A commenter stated that it understands that HUD is proposing to eliminate existing 2530 Form. The commenter urged HUD to retain the clarity and predictability that was intrinsic to the prior 2530 Form and instructions.

*HUD Response:* HUD did not propose and is not proposing to eliminate the 2530 Form. As HUD responded to a similar comment submitted on the proposed rule, HUD advised that, based on experience under the new regulations, HUD may propose alternative versions of the 2530 form more tailored to a specific HUD program. However, at this point in time, HUD is not proposing any alternative versions and HUD is not proposing elimination of the 2530 Form.

*Exclude defaults that are beyond the participant’s control.* A commenter stated that the Processing Guide directs participants to disclose on Schedule A defaults in housing projects participating in other Federal, State or local government program but should recognize that lenders and other parties are often required to “declare” technical

defaults that are quickly corrected. The commenter also suggested that HUD should exclude defaults that were beyond the participant’s reasonable control.

*HUD Response:* HUD has revised the Processing Guide’s instructions on Schedule A to indicate that only defaults declared and remaining after applicable cure periods should be disclosed. HUD has also revised the Processing Guide to include considerable guidance as to when participation should be approved despite the presence of flags and lists the default being outside the participant’s control as a factor to be considered and documented.

#### Definitions

*Support for definition of “Risk.”* A commenter expressed support for the definition of “risk” and stated that, in its previous comment on the proposed rule, it requested that, “HUD should clearly explain in the rule what constitutes acceptable and unacceptable risks to a property’s finances and operations.” The commenter stated that HUD addressed its concerns by proposing a definition of risk in the regulatory text, and listing specific types of flags in the Processing Guide.

*HUD Response:* HUD is gratified that it was able to address the commenter’s concern.

*Clarify definition of Covered Projects.* Two commenters recommended that HUD revise the Processing Guide to expressly indicate whether “Covered Projects” include non “Subsidized Projects” with no HUD-insured/HUD-held loan or HUD subsidy, but with a HUD Use Agreement or similar document (e.g., deed) imposing HUD use restrictions. The commenters asked, for example, whether a project subject to an Interest Reduction Payment (IRP) decoupling Use Agreement (236(e)(2) Use Agreement), but where the IRP has already been exhausted, a “Covered Project” subject to 2530 review. The commenters also asked whether a project subject to an Emergency Low-Income Housing Preservation Act (ELIHPA) or Low-Income Housing Preservation and Resident Homeownership Act (LIHPRA) Use Agreement, but with no HUD insured/held loan and no remaining HUD subsidy, is a “Covered Project.”

*HUD Response:* HUD has revised the Processing Guide to state more clearly that projects with Use Agreements administered by HUD’s Office of Housing are Covered Projects. As such, the examples the commenter lists would be Covered Projects.

*Repeat definitions in Processing Guide.* A commenter stated that it would be beneficial and remove any room for uncertainty, if a definition section were added to the Processing Guide. The commenter pointed to use of the terms “controlling stockholder” and “controlling shareholder” as undefined and ambiguous. The commenter further stated that it would benefit all interested parties if there were consistency between the MAP Guide and the previous participation regulations and the Processing Guide. The commenter stated that the MAP Guide draws the line at 10 percent ownership for corporations and stockholders, but the Processing Guide is silent on it and therefore creates ambiguity.

*HUD Response:* HUD believes that a definition sections would be largely duplicative and might not catch all the terms the commenter is looking for. HUD agrees that use of the terms “controlling stockholder” and “controlling stakeholder” was ambiguous and that coordination with the MAP Guide would be beneficial. HUD has revised the Processing Guide accordingly.

*Define “significant changes.”* A commenter stated that the Processing Guide contains numerous references to “significant changes,” a term which is not defined. The commenter stated that this term is ambiguous and should be clarified in a meaningful way.

*HUD Response:* “Significant changes” is a concept often used and sufficiently clear. For example, if HUD were to change what violations result in flags, that is a significant change. If HUD were to clarify the language describing the flag, without a substantive difference in the violation that is triggering the flag, that is not a significant change. If HUD were to change a policy relating to who is considered to be a Controlling Participant, this would be a significant change. If HUD were to clarify the language describing who a Controlling Participant is, but not change whether or not such an individual or entity is considered to be a Controlling Participant, such change would not be significant. Individual determinations on specific transactions are not changes to the Processing Guide.

*Definition of “risk.”* A commenter noted that HUD stated its intention to provide a definition of “Risk” in 24 CFR 200.212, but HUD did not include the actual proposed regulatory definition for review or comment. With respect to the definition of “risk,” the commenter stated that there are no time restrictions set forth in HUD’s description of what constitutes risk and no consideration of whether such risks have been mitigated.

*HUD Response:* With respect to the commenter’s concern about the absence of proposed regulatory changes presented in a non-codified manner, it is important to note that an agency may propose regulatory text without setting out the regulatory text in the manner it would be codified provided the agency presents a sufficient description of the regulation to be issued.<sup>8</sup> HUD provided a sufficient description of the proposed changes. With respect to the concerns regarding the substance of what constitutes “risk,” in response to this comment and others, HUD has revised the Processing Guide to specify what factors shall be considered in evaluating the risks posed by flags and clarifying when it is appropriate to approve or disapprove an applicant.

#### Determining Who Is Subject to Previous Participation Review

*HUD retains broad discretion to determine who is subject to previous participation review.* A commenter stated that the proposed regulations reserve to HUD the ability to unilaterally determine who is subject to review, which creates uncertainty in the review process. The commenter stated that it supports the effort to identify and restrict the participation of individuals with a record of poor performance, but is concerned about the broad discretion for HUD to add individuals subject to previous participation review. The commenter stated that since it is difficult for HUD to clarify how or when it might determine additional individuals to be subject to review, HUD should limit the identification of additional individuals (beyond those with specified roles) to individuals for whom there is some reason to believe represent a risk to HUD programs. Another commenter stated that HUD must specify in a meaningful way how it would unilaterally “determine” that an individual or entity does or does not exercise financial or operational control, otherwise the lack of specificity regarding HUD’s determinative process makes the regulation vulnerable to a void for vagueness claim and increases uncertainty.

*HUD Response:* HUD agrees in part and disagrees in part. HUD notes that the Processing Guide provides examples of every kind of entity that we can currently think of and who would be

<sup>8</sup> “[T]he agency usually publishes the regulatory text of the proposal in full. The regulatory text sets out amendments to the standing body of law in the Code of Federal Regulations. If the amendments are not set out in full text, the agency must describe the proposed action in a narrative form.” See [https://www.federalregister.gov/uploads/2011/01/the\\_rulemaking\\_process.pdf](https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf).

considered a Controlling Participant in such circumstance. HUD has also provided a specific list of exclusions of who HUD does not consider to be Controlling Participant. However, due to the volume of transaction that HUD oversees, it is unavoidable that HUD will not be able to list definitively every possible scenario. In fact, this is one problem with the current regulations which contemplate a number of scenarios, but not every possible scenario. For these unanticipated scenarios, HUD must be able to use discretion. Further, HUD notes that there are sometimes errors in the disclosure, whether advertent or inadvertent. Where HUD has reason to believe that an entity or individual other than those disclosed is actually exercising control over the Covered Project, HUD’s oversight responsibilities require HUD to inquire about such entities and individuals. This is the essence of the regulations. It is not sufficient to structure a project in technical compliance of the anticipated scenarios that HUD lists in its guidance and shield controlling parties from appropriate review of their previous participation. Parties are unequivocally on notice—whoever actually controls a project is subject to Previous Participation Review.

However, HUD agrees great clarity where possible is beneficial. HUD has clarified in the Processing Guide that it is the lender’s (in FHA-insured transactions) and applicant’s responsibility the first instance to make the determination in accordance with HUD guidance of who is a Controlling Participant. HUD has also clarified that once HUD provides final approval for a Triggering Event, HUD will not re-open the question of who is a Controlling Participant. Finally, HUD has revised the Processing Guide to clarify some of the provisions that other comments indicated were ambiguous.

#### Commencing the Previous Participation Review Process

*Incorporate guidance in the Processing Guide that instructs reviewing offices to commence previous participation with their review of the application for mortgage insurance.* A commenter stated that requiring the reviewing office to initiate the previous participation review when the application is accepted will allow for any flags to be identified and mitigated simultaneously with the processing of the application for mortgage insurance.

*HUD Response:* HUD has revised the Processing Guide to indicate that previous participation review occur concurrent with the review of the

application for mortgage insurance or other request for approval of a Triggering Event.

#### Defining Controlling Participant

*Clarify meaning of construction manager.* Three commenters stated that HUD should provide additional clarification and a definition regarding the title of construction manager.

*HUD Response:* As shown on the Processing Guide, “construction manager” is only a Controlling Participant for section 242 hospital transactions and it is a clearly known term in such transactions.

*Make clear the controlling participants that have operational or policy control.* Three commenters stated HUD should clarify whether the enumerated List of Controlling Participants in the Processing Guide is meant to define the participants that HUD is identifying as those HUD determines to have operational or policy control.

*HUD Response:* HUD has revised the text to clarify that the enumerated list are those entities and individuals considered to exercise financial or operational control in the stated circumstances.

*Identify separate standards for determining Controlling Participants for public companies.* A commenter stated that titles and roles of participants with control over a Covered Project can vary greatly between a publicly held company and a private company, and HUD should identify separate standards for determining Controlling Participants for publicly held companies, REITs and private corporations.

*HUD Response:* HUD notes that REITs are already separately listed. HUD has revised the language in the Processing Guide to be more specific and believes that for both public and private corporations, the officers and other equivalent executive management who are directly responsible to the board of directors and who have the ability to prevent or resolve violations or circumstances giving rise to flags related to the Covered Project are the appropriate submitters.

#### Lists of Controlling Participants

*Suggested changes to List of Controlling Participants.* Commenters submitted the following suggested changes to the list of Controlling Participants:

*Item 2—*“and other executive management” is far too broad and supplies HUD with too much discretion. Commenters stated that Item 2 needs to be refined to drill down to only the

officers/individuals with decision-making and/or financial capacity.

*HUD Response:* HUD has revised this item to focus on officers and other equivalent executive management who are directly responsible to the board of directors and who have the ability to prevent or resolve violations or circumstances giving rise to flags related to the Covered Project.

*Item 7—*Executive Director of a nonprofit sponsor. HUD needs to specifically define when a Sponsor comes into play and when it does not.

*HUD Response:* HUD has deleted the word “Sponsor.” The Controlling Participant of a non-profit is the Executive Director or equivalent position.

*Item 10—*There is no definition supplied for Controlling Stockholder, and the industry should have the right to comment on such definition, as it relates directly to principals and reporting disclosure. One of the commenters stated that HUD needs to define or clarify that it adheres to the MAP Guide.

*HUD Response:* HUD has clarified this item.

*Item 14—*This language is way too broad. If an entity is an “excluded entity”, by definition it is not considered a Controlling Participant, so its officers, directors, or executive management team should be excluded as well (unless there is an indication of interest (IOI) with other identified Participants or the combined financial percent exceeds other stated requirements.)

*HUD Response:* HUD has revised this section to provide greater clarity.

*Address inconsistency in Processing Guide on the applicable ownership percentage.* A commenter stated that there appears to be some conflicting guidance between these two items, which span the “List of Controlling Participants” section (item 1) and the “List of Exclusions” section (item 7). The commenter stated that Item 1 appears to be implying that the applicable ownership percentage is to be calculated based upon that entity’s or individual’s effective ownership in the Specified Capacity whereas item 7 implies that the applicable ownership is based on the actual ownership on an entity by entity basis.

*HUD Response:* HUD has revised the text to clarify this discrepancy.

*Provide notification when additions are made to list of controlling participants.* Two commenters stated that portions of the Processing Guide indicate that any person or entity “determined by HUD to exercise day-to-day control over a Specified Capacity”

is a Controlling Participant. The commenters stated that if HUD intends to reserve the right to expand the list, we recommend that HUD identify (a) how/when the proposed participant will receive notice of any additional parties that must be included as Controlling Participants, and (b) what standards HUD will apply for such purpose.

*HUD Response:* HUD has added additional specificity to this provision.

*Supplement the list of controlling participants with examples.* A commenter expressed support for HUD’s efforts to streamline and clarify the previous participation process by limiting 2530 approval requirements to those who have day-to-day financial or operational control of properties. The commenter stated that it was especially pleased that tax credit investors and passive participants are excluded from requirements to seek approval. The commenter recommended that HUD provide additional guidance, and perhaps a few examples, to determine which for-profit and nonprofit board members must seek approval.

*HUD Response:* HUD has clarified the language regarding for-profit board of directors. Members of a non-profit’s board of directors do not need to file.

*Protect innocent fee managers from punitive measures.* A commenter stated that it recognized HUD’s interest in having management agents file for 2530 approval, but that it remained concerned that the Processing Guide offers no safe harbor to protect innocent, unrelated, third-party fee managers from being flagged or otherwise penalized for owners’ decisions outside of their control. The commenter stated that provided such managers did not participate in health or safety violations or financial impropriety, these fee managers can only affect the property operations to the extent the owner permits funds to be released. The commenter urged HUD to shield innocent fee managers who acted in good faith from punitive measures, so that capable managers are not discouraged from taking over troubled properties.

*HUD Response:* HUD notes that property managers do sometimes contribute to the violations relating to a covered project. However, HUD has revised the Processing Guide to indicate more clearly that HUD will not flag Controlling Participants who did not contribute to or fail to prevent, when in a position to do so, the violation giving rise to the flag.

*Clarify whether “ability to bind” will remain in the final rule.* A commenter asked whether “ability to bind” will remain as a threshold in the final rule.

*HUD Response:* A similar comment was submitted and HUD retains the concept but revises the language in the final rule to state the “ability to direct the entity in entering into agreements.”

#### List of Exclusions From Controlling Participants

*Suggested changes to List of Exclusions.* Commenters submitted the following suggested changes to the list of exclusions:

*Item 5*—HUD should not require “all of the officers of the entity to certify as to who have significant or insignificant involvement . . .”

*HUD Response:* HUD agrees that it may not be practical to have all officers certify and has revised the Processing Guide to provide an alternate standard.

*Item 7*—The language “less than 25 percent interest in an entity should be excluded” should be changed to read “less than 25 percent interest in a Specified Capacity should be excluded” to conform with Item 1 under List of Controlling Participants.

*HUD Response:* HUD agrees that the two items should be consistent but has revised Item 1 under the List of Controlling Participants to conform with this item.

*Item 10*—HUD has not clearly identified how they are determining who has financial or operational control. The commenters stated that this must be addressed under the List of Controlling Participants.

*HUD Response:* HUD has clarified the language in the List of Controlling Participants to be more specific.

*Clarify why HUD used different definitions of Controlling Participant in the proposed rule and in the proposed Processing Guide.* A commenter asked why HUD used different definitions of a “Controlling Participant” in the proposed regulations and the Processing Guide. The commenter asked whether these definitions could be made consistent. The commenter stated that alternatively, the definition and concept of a “Specified Capacity” could be added to the proposed regulations.

*HUD Response:* HUD has added the concept of “Specified Capacity” to the regulations and has made all definitions more consistent.

*Clarify distinction between shell entity and wholly-owned entity.* A commenter noted that the list of exclusions includes wholly-owned entities and shell entities, but noted that they are the same.

*HUD Response:* HUD agrees that many wholly-owned entities are shell entities, but shell entities are not necessarily wholly-owned entities. HUD includes both listings for completeness

and believes this listing will provide greater clarity.

*Describe how HUD determines whether an identity of interest or other conflict of interest exists.* A commenter stated that HUD should define in a meaningful way how it would unilaterally determine whether an identity of interest or conflict of interest exists.

*HUD Response:* HUD has corrected the typo in this section. HUD notes that this item clearly states that the program requirements, which have extensive identity of interest provisions, govern. It is only in the instances when the program in question fails to include identity of interest provisions would HUD need to make a determination on this issue.

*The 25 percent ownership presents a complicated method of inclusion or exclusion.* A commenter stated that some of HUD’s exclusions are very helpful (including tax credit investors, passive participants, minor officers, members of a board), but that others are complicated—such as the less than 25 percent ownership interest, particularly having to aggregate your percentage with others with whom you have an identity of interest or conflict of interest.

*HUD Response:* HUD thanks the commenter for the support. If the commenter has a simpler suggestion to replace the 25 percent ownership interest concept that adequately protects HUD’s interest, HUD encourages the commenter to make a suggestion.

#### Organizational Chart

*Suggested Changes to Organizational Chart.* Commenters submitted the following suggested changes to the organizational chart:

*Item 2*—The commenters stated that it takes great exception to the requirement for provision of an Organization Chart that requires the disclosure of “all participants”. The commenters stated that shareholders, members and limited partners with no operational or policy control and/or those with minimum financial interest should not be required. The commenters stated that the required Organization Chart should be limited to Controlling Participants, and pass-through entities and shell entities that culminate in revealing a Controlling Participant. The commenters stated that Passive Participants and other excluded parties should not be required on the Organization Chart.

*HUD Response:* HUD notes that organizational charts are already required with the applications for Triggering Events. Further, HUD notes that the purpose of the organizational

chart is to help HUD confirm that the appropriate individuals and entities are identified as Controlling Participants and they cannot serve this purpose if they only disclose those individuals already disclosed. However, HUD agrees that in some instances the identification of each ownership interest may be overly burdensome and has revised this requirement accordingly.

*Item 6*—Individuals and entities that are not Controlling Participants should not be reviewed for limited denial of participation (LDP). The commenters stated that if there is no ability to control, this is not relative to assessing risk.

*HUD Response:* HUD agrees and has removed this requirement.

*Item 7*—If a Director is not considered to be a Controlling Participant then the Director should not be required to be listed on the Organization Chart. The commenters stated that this is specifically onerous for REITs or publicly held companies or any organization with a large investment pool, but is also an unnecessary burden for private corporations and nonprofit entities.

*HUD Response:* HUD has revised the requirements for entities in which the requirement may be overly burdensome.

*The requirement for an organizational chart for all parties in all roles regardless of ownership percentages and decision-making capacities is onerous and prohibitive to the intent and spirit of the original rule.* A commenter made a similar comment to that made by other commenters about the organizational charts, and largely focused on burden. The commenter stated that lenders go through significant due diligence during underwriting to determine the true and correct ownership structure(s), and they do this through reviewing ownership agreements, partnership documents, organizational charts and discussions with the borrower and their attorney.

*HUD Response:* If the applicant is already gathering the information needed for other portions of an application, it is difficult to understand why submitting this information into the APPS system for the purpose of previous participation review would be onerous. Further, as stated above, the purpose of the organizational chart is to make sure that the individuals and entities identified as Controlling Participants make sense. Finally, HUD has revised these provisions to clarify HUD’s intent and reduce the burden where appropriate.

*Eliminate all references to “all officers.”* A commenter suggested that HUD eliminate reference to “all officers” of a corporation throughout the

Processing Guide and limit previous participation review and approval to only those officers who are in an executive managerial position and exercise financial or operational control over the borrower, owner, etc.

*HUD Response:* HUD has revised this provision to exclude the officers of wholly owned entities, tax credit investors and other investors that are not exercising day-to-day control, which HUD believes addresses the majority of situations that the commenter is referring to. HUD has further revised this section to indicate that HUD may accept an organizational chart without a full listing of an entity's Board of Directors if HUD determines that such a listing would be unduly burdensome.

*Establish one clear criterion for determining when an officer must obtain previous participation approval.* A commenter stated it would be more efficient and provide greater predictability for applicants if HUD establishes one clear objective criterion for determining whether an officer must obtain previous participation approval.

*HUD Response:* HUD has clarified this requirement.

*The chart is helpful in demonstrating financial and operational control.* A commenter stated that the chart is very helpful in demonstrating who has financial and/or operational control over the property.

*HUD Response:* HUD agrees.

*It is unclear if HUD has authority to review any information requested by HUD regarding widely held interests without regard to the connection to the Covered Project.* A commenter stated that it is unclear whether HUD possesses the authority to review "all participants" beyond those defined as principals or Controlling Participants. The commenter stated that it is unclear if HUD has the authority to review "any information requested by HUD" regarding widely held interests without regard to the connection to the Covered Project.

*HUD Response:* HUD does not propose reviewing the previous participation of entities or individuals who are not Controlling Participants. HUD does not propose examining information that is unrelated to a Covered Project. The information provided through the organizational chart is meant to confirm the information presented to HUD identifying who the Controlling Participants are—how can HUD know if applicants are submitting the entities in control unless the full organizational structure is disclosed? That being said, HUD has revised this section to

eliminate undue burden and clarify these requirements.

*Filing the Previous Participation Certification*

*Provide a separate section in the Processing Guide for Participant Disclosure.* A commenter stated that it appreciated the detail and attention that HUD has put into this section of the proposed Processing Guide, as these elements will be most helpful for applicants, but that the commenter felt strongly that a separate section in the Processing Guide titled "Participation Disclosure" should be included, immediately following the section on Organization Charts and before the section on Filing of Previous Participation Certification. The commenter stated that traditionally, the detail on which projects must be included as previous participation has been cause for much confusion by applicants. The commenter stated that it greatly appreciated the new detail and clarity on previous participation found in the proposed Processing Guide, but this detail is buried in the instructions to the paper forms. The commenter stated that it assumes that HUD intends this to apply to all filing methods, not just the paper HUD 2530, and as such, this should receive separate treatment in the Processing Guide under a separate section header.

*HUD Response:* This has been clarified in Section C in the Processing Guide.

*Clarify the required certifications.* A commenter stated that the current previous participation regulations include a section titled Content of Certifications. The commenter stated that neither the proposed rule nor the proposed Processing Guide identify the specific nature of the certifications that will be part of a previous participation submission.

*HUD Response:* The certifications are stated on the form 2530. As HUD has indicated, HUD is not changing the certifications to the 2530 at this time. If HUD were to do so, it would put the form through the PRA process, including the necessary notice and comment period.

*Support for HUD's provisions.* A commenter expressed its support for HUD's provisions that allow participants to utilize either the electronic APPS or a paper alternative (currently known as the Form HUD-2530). The commenter expresses support that HUD only requires participants to list all projects that they have participated in over the previous 10-year period. The commenter noted that HUD reserves the right to review

and consider a Participant's previous participation in a Federal project beyond the 10-year period when determining whether to approve participation in the project associated with an application. The commenter stated that in its previous comments on the proposed rule, it recommended limiting the timeframe covered in the review to a 10-year look-back period, consistent with instructions of the current Form HUD-2530.

*HUD Response:* HUD appreciates the support.

*Explain why HUD may review a participant's previous participation beyond the 10-year period.* A commenter stated that HUD should meaningfully clarify the reasoning behind its reservation of rights to review and consider participant's previous participation in a federal project beyond the 10-year certification period.

*HUD Response:* Only Tier 1 flags, which are permanent flags, would survive beyond the 10-year period. HUD believes these violations are so severe that they warrant permanent documentation in the record. However, HUD has clarified how HUD will evaluate the risk presented by these flags and when it is appropriate to approve a participant with these flags.

*Approval of Participants*

*Clarify whether approval of participant is prohibited by any flag (i.e. historical flag) or only an active flag.* A commenter stated that the opening paragraph of this section indicates that HUD intends to provide approval of a submission if applicants do not have flags and are able to make all the certifications. The commenter stated that HUD should clarify whether this applies to any historical flags or only to active flags.

*HUD Response:* Only active flags require review. However, HUD notes that an underlying issue may be "resolved" but the flag may be "active" until the time period indicated in the Processing Guide expires. Tier 1 flags remain active permanently. Tier 2 flags remain active until the time periods specified expire.

*Require HUD to provide a participant with written approval or denial.* Two commenters stated that the Processing Guide identifies the circumstances under which a 2530 submission will be approved. The commenters recommended that the Processing Guide also require HUD to, within 30 days of its receipt of the submission, provide the proposed Participant with (a) written evidence of HUD's approval or denial of the submission (and the justification for any denial), or (b) a



written statement identifying what additional information, if any, is required for HUD to complete its consideration of the submission.

*HUD Response:* HUD does not agree with the specific suggestions made by the commenter but agrees that greater detail regarding notice and documentation is needed and has revised the Processing Guide accordingly.

*Provide notification of the duration of 2530 clearance.* Two commenters recommended revising the Processing Guide to indicate how long a Controlling Participant's 2530 clearance remains in effect—and what procedures, if any, a Participant can follow to extend the effective period of the clearance without making a whole new submission.

*HUD Response:* HUD believes the charts indicating the duration of the flags address the commenters concerns.

*Clarify approval of participants as it relates to various HUD offices.* A commenter stated that it would be beneficial for HUD to include guidance in this section on the processing responsibilities of the approval process as it relates to Satellite Offices, Hub Offices and Headquarters.

*HUD Response:* HUD has provided a web address linking to the additional contact information requested.

*Clarify how quickly HUD will issue approval.* A commenter stated HUD should clarify how quickly it will issue approvals. The commenter suggested that HUD should commit to approving such submissions within 14 days of receipt. The commenter further stated that the fourth bullet point of this section should clarify how far back in time HUD will retain and judge participants' flag history. The commenter stated that as currently worded, it appears HUD may hold and consider such flag history indefinitely.

*HUD Response:* HUD cannot commit to a response within 14 days. Only Tier 1 flags are permanent. The charts detailing the flags specifically list the duration of the flags.

*Clarify what it means to limit or otherwise condition approval of the Controlling Participant to continue to participate in the Triggering Event.* A commenter stated that HUD must clarify what it means to "limit" or "otherwise condition" approval for the Controlling Participant to continue to participate in the Triggering Event.

*HUD Response:* HUD has revised these provisions to provide greater clarity and specificity.

*Clarify how a participant presents a significant risk to HUD.* A commenter stated that HUD should clarify in a

meaningful way how it determines that a participant presents a "significant risk" to HUD and also define what remedies and/or mitigation of outstanding violations will satisfy the criteria "to the FHA Commissioner's satisfaction".

*HUD Response:* HUD has added considerable detail to clarify what factors must be considered in evaluating the risks identified by flags.

#### Flags

*Comments on flags:* A commenter provided the following comments on flags:

*Who to flag.* Specifically stipulate that participants who are not Controlling Participants should not be flagged.

*HUD Response:* HUD has added greater detail on who should and should not be flagged.

*Tier 1*—The commenter stated that it takes exception with the notion of permanent flags outlined in the proposed Processing Guide. The commenter stated that HUD appears to advocate that individuals cannot rehabilitate and that one instance of past behavior is a permanent indicator of all future actions.

*HUD Response:* HUD believes that the violations resulting in Tier 1 flags are so serious that they warrant permanent consideration. However, HUD has added greater clarity regarding what factors to consider in evaluating this risk and has specified when it may be appropriate to approve a participant with a Tier 1 flag.

*Tier 2*—The commenter stated that in all instances where the reason includes the qualifier "repeated", HUD should clearly identify if the intent is concurrent repeated acts or a certain number within a given time frame.

*HUD Response:* HUD has clarified the definition of "Repeated" in the text immediately above that chart.

*Tier 3—Unacceptable Physical Condition*—The commenter stated that this does not match the current policy in place at REAC. REAC should be prepared to issue a revised policy concurrent with the release of this proposed Processing Guide.

*HUD Response:* The Processing Guide is the revised policy.

*Subject of flags must address HUD's failure to abide by its own contractual, statutory or regulatory requirements.* A commenter stated that no allowances are made for events of non-compliance that may be due to HUD failure to abide by its own contractual, statutory or regulatory requirements. The commenter stated that, for example, late payments of funds owed by HUD that result in late payment of loans should

not be penalized and no flags should be placed. The commenter stated that similarly, flags for unsatisfactory management reviews should be removed because of HUD's failure or inability to conduct or contract for management reviews within a 12-month period of the last unsatisfactory review due to conditions that are outside of the control of program participants.

*HUD Response:* The Processing Guide was updated to address situations outside of the controlling participant's control. In addition, HUD has clarified situations where projects can be approved despite a Tier 3 flag.

*Define "minor infractions" and clarify that flags may not be used to induce certain action.* A commenter stated that in addition to the prohibition that flags shall not be placed for "minor infractions," which should be defined, HUD should clarify that likewise flags may not be used by HUD punitively to induce a participant to undertake a desired action or to punish a participant for action(s) HUD deems undesirable.

*HUD Response:* The Processing Guide has been revised in accordance with this comment. The Processing Guide sets forth reasons that flags may be placed: Punishment or inducement to take action are not among them. One example of a "minor infraction" would be a situation where a new participant to HUD accidentally took unauthorized distributions, but immediately repaid them upon realizing the mistake.

*Define "Repeated Offense."* A commenter stated that HUD should define a "Repeated Offense" to be three or more occurrences within the most recent five (5) year period, otherwise participants' distant past would cloud perceptions of recent performance, and recent performance arguably should be the most relevant criteria and of most interest to HUD.

*HUD Response:* HUD agrees that a time period should be specified here. The Processing Guide has been clarified to provide for a seven (7) year period.

*No flag should be permanent.* A commenter stated that HUD should recognize that in many instances, a default occurs due to circumstances beyond the Participant's reasonable control. The commenter recommended that HUD expressly indicate that the imposition of any flag shall be based on the particular facts and circumstances relating to the subject project. The commenter stated, that for example, if a participant is able to demonstrate that a loan default occurred due to a downturn in the local market, and the participant undertook reasonable efforts to cure the default (e.g., seeking to increase occupancy and/or revenues, seeking to

reduce expenses), the participant should not have a “permanent flag” or, for that matter, any Tier 2 or Tier 3 flag on its record. This commenter and two other commenters recommended that no flag should be “permanent.”

*HUD Response:* The Processing Guide has been updated to reflect situations outside of a participant’s control. HUD does want to maintain permanent flags on the Tier 1 events due to their severity but has clarified when approval is appropriate, even if a Tier 1 flag exists.

*Expressly state that passive investors are not subject to 2530 flags.* Two commenters stated that HUD should revise the Processing Guide to expressly indicate that investors/syndicators/passive investors who do not exercise day-to-day control should not be subject to 2530 flags based on the actions/inactions of other persons/entities.

*HUD Response:* The Processing Guide addresses this in exclusions three and four.

*Enter Tier 1, 2, or 3 flags for only Controlling Participants that participate during the violation.* Three commenters stated that HUD should indicate that flags will only be entered against Controlling Participants that exercise day-to-day control over the operations of the Covered Project during the period the default actually occurred and a proposed incoming participant will not be flagged based on a violation occurring prior to the participant’s participation in the Covered Project.

*HUD Response:* The Processing Guide has been updated to reflect this.

*Eliminate automatic flag triggers.* A commenter urged HUD to eliminate “automatic” flag triggers, such as those generated by a change in ownership that do not necessarily represent additional risk to HUD but inevitably create additional reporting burdens for owners.

Another commenter urged HUD to refrain from placing automatic system flags. The commenter stated that APPS generates unnecessary automatic flags, which the participant must then go to the trouble of having them removed. The commenter stated, for example, one member reported multiple problems with automatic flags after properties are refinanced and sold to a newly created entity. The commenter stated that according to one of its members, the participant cannot file financial statements into HUD’s Financial Assessment Subsystem—Multifamily Housing (FASSUB) until an audit template is ready in the Integrated Real Estate Management System (iREMS).

*HUD Response:* The only automatic flag is for Failure to File Financial Statements. HUD staff has readily available access to determine whether

the financial statements have been filed and can easily remove flags once the financial statements are filed in HUD’s system. Refinement of this process is outside the scope of the regulation. HUD will continue to review this system and determine whether additional changes would be feasible. HUD will explore alternative solutions to make sure AFS filings after ownership transfers happen in a timely manner, such as staff training and adding the item to the checklist of standard work on ownership transfers.

*Expressly indicate that the imposition of any flag shall be based on the particular facts and circumstances relating to the subject project.* Two commenters stated that HUD should recognize that in many instances, a default occurs due to circumstances beyond the participant’s reasonable control. The commenters recommended that HUD expressly indicate that the imposition of any flag shall be based on the particular facts and circumstances relating to the subject project, stating, for example, if a participant is able to demonstrate that a loan default occurred due to a downturn in the local market, or the occurrence of an uninsured or underinsured natural disaster (such as an earthquake) and the participant undertook reasonable efforts to cure the default (e.g., seeking to increase occupancy and/or revenues, seeking to reduce expenses), the Participant should not have a flag on its record.

*HUD Response:* The Processing Guide has been updated to address this.

*Reconcile duration of Tier 1 flags with duration of 10-year look-back.* A commenter urged HUD to reconcile the duration of these flags with the 10-year look back period. In other words, Tier 1 flags should not remain on a participant’s record longer than 10 years.

*HUD Response:* While a participant is not required to report participation beyond the 10-year period, HUD believes that Tier 1 violations are severe enough to warrant a permanent record. In response to concerns raised in the comments, HUD has clarified the factors that should be considered when evaluating Tier 1 flags and has explicitly provided for circumstances under which participants with Tier 1 flags may be approved.

*Reduce duration of Tier 2 flags from 5 years to 3 years.* A commenter urged HUD to reduce the timeframe for retaining Tier 2 flags from 5 years to 3 years, provided the cause of the flag is corrected. The commenter stated that it believes 3 years provides sufficient time for HUD to determine whether the

problem that led to the flag has been addressed.

Two commenters similarly urged HUD to modify the inflexibility of the duration of Tier 2 Flags. The commenters stated that resolution of flags is an important tool for HUD when negotiating settlement of disputes between owners and HUD, which will be lost if HUD cannot settle a matter and lift a Tier 2 Flag. The commenters stated, for example, assertion of audit findings by the Office of Inspector General, or by FASS may be contested by the Owner, but will nevertheless result in a Tier 2 Flag. The commenters stated that in order to resolve the audit findings, without resorting to litigation by HUD or the Owner, HUD should be free to resolve the Flag issue and remove the flag, without waiting out the five-year period.

*HUD Response:* HUD does not believe that three years is a sufficient amount of time to indicate a complete resolution of the risk. The Processing Guide has been revised to provide explicitly considerations to evaluate whether approval is warranted despite the presence of flags.

*Tier 3 flags should be removed when the underlying reason for the flag is cured or 3 years after placement, whichever is sooner.* A commenter stated that a number of Tier 3 flags will be considered repeat violations and may occur over a period of years. The commenter strongly urged HUD to develop safeguards for innocent owners and third party management agents who take over troubled properties. The commenter stated that, as HUD is aware, it will take time to put the necessary resources, personnel and procedures in place to turn around such properties. The commenter stated that it serves the public interest to have the most capable owners and agents rise to meet these challenges, but in the absence of a safe harbor which protects the new owners and managers from being flagged as a result of their predecessors’ decisions, high-performing ownership and management teams may be deterred from assuming responsibility associated with these projects. The commenter requested that HUD add written safe-harbor policies to protect innocent owners and managers from flags as they are turning around troubled properties. Another commenter similarly stated that Tier 3 flags should be removed when the unauthorized distribution is repaid “or is otherwise resolved”, because not all alleged unauthorized distributions are indeed unauthorized payments and may be resolved via means other than repayment.

*HUD Response:* The Processing Guide has been revised in accordance with this comment.

*An appropriate time frame for a Tier 3 flag is one year.* A commenter stated that the maximum time frame that Tier 3 flags should remain active is one year.

*HUD Response:* HUD disagrees. Flags are a reflection of non-compliance with HUD obligations, which is considered serious. The Processing Guide has been updated to provide additional guidance for situations in which Controlling Participants can be approved despite a flag.

*Disconnect between REAC policy and unacceptable physical condition for Tier 3.* Two commenters stated that the unacceptable physical condition for Tier 3 does not match the current policy in place at REAC. The commenters asked whether REAC would issue a revised policy concurrent with the release of this Processing Guide. Another commenter stated that placement of flags for unacceptable physical conditions departs from current policy guidance, which requires consecutive below-60 scores before flags are placed. The commenter stated that a look back period of 5 years is unduly harsh for conditions posing a temporary risk to the department, and that a two- or three-year period would be more appropriate.

*HUD Response:* HUD takes REAC scores very seriously. The Processing Guide is an update to HUD's policy and future notices; guidance issued by REAC will follow. The Processing Guide has been revised to clarify that participants will be approved despite having initially scored between 30–59 at a property, on the condition they perform a 100 percent unit inspection and complete necessary repairs within 60 days. A subsequent score below 60 within the 5-year time period will merit a flag.

*Incorporate a routine process to release flags without the participant's request.* A commenter stated that HUD has incorporated guidance on its protocol for placing flags on participants which is helpful, particularly with regard to the tiers and weighting of certain flags, but the commenter asked HUD to be cautious in adding many automatic flags on participants. The commenter also asked whether HUD could incorporate a routine process to release flags without the participant's request. The commenter stated that this would be particularly helpful at the Tier 3 level when events known to HUD occur and trigger a flag through no fault of the borrower. The commenter stated, for example, when Section 8 PBRA payments have not been distributed as

scheduled, it could potentially cause a borrower to miss mortgage payments.

*HUD Response:* While this is beyond the scope of the regulations or Processing Guide, HUD is working on a process to standardize the removal of flags, which process should not be predicated on a request from the Participant.

*Inability to see "critical findings" and the need for easier method for program participant to accept certain findings.* A commenter stated that, in the APPS system, the owner/agent can see flags, but not "critical findings." The commenter recommended that HUD develop an easier method than program participants having to "Accept" every management and occupancy review (MOR) and REAC finding, specifically having to "Accept" them on each entity. It is repetitive and unnecessary to "Accept" each finding on the ownership entity, the management entity, and each corporate officer's entity. The commenter reiterated that it seems like there should be an easier method.

*HUD Response:* The commenter is confused; "critical findings" in the APPS system mean that there are flags on the record. The system processing of "accepting" reviews is outside the scope of this final rule, but HUD will look into the feasibility of updating the system to simplify the submission process.

*Chart on Approval of Participants With Flags*

*Include in the chart links to relevant HUD staff.* A commenter stated that while HUD's chart is helpful, further clarification is needed. The commenter stated that the chart uses HUD staff titles that correspond with the ongoing Multifamily for Tomorrow Transformation Initiative, but participants may or may not yet be familiar with this structure. The commenter recommended including links to contact information for each official noted, stating, for example, that HUD should include links and/or additional charts that list each branch chief, production division director and asset management division director within the new multifamily field office structure.

*HUD Response:* HUD agrees that additional information would be helpful and will provide such information on its Web site. The Processing Guide has been revised to reflect this additional resource.

*Rejection of Participants*

*Support for notification requirement.* A commenter stated that it strongly supported HUD's proposal that HUD staff will notify the participant, or

lender, if applicable, in advance of the recommended decision. The commenter stated that this notification will allow an opportunity for the participant to provide additional arguments for HUD's consideration to preserve processing efficiency and cut down on requests for reconsideration. Two other commenters recommended that the Processing Guide also indicate that HUD will identify in writing to the proposed participant, in reasonable detail: (a) The anticipated basis for the denial, and (b) what information, if any, is needed to resolve HUD's concerns. Another commenter stated that HUD should specify how much advance notice participants and lenders shall receive before a recommendation for rejection is proposed. The commenter stated that meaningful notice periods must be provided for due process purposes.

*HUD Response:* The Processing Guide has been revised in accordance with this comment. HUD believes that it is quite strongly in compliance with any due process considerations.

*Reconsideration of a Rejection*

*Stipulate that the HUD individual making the appeal decision is not the same HUD individual who initially rejected the Participant's appeal.* A commenter expressed support that participants have the right to request reconsideration of HUD's decisions to reject participants. The commenter requested that the Processing Guide stipulate the individual (*i.e.*, HUD staff) making the decision on the appeal must not be the same person who initially rejected the participant. The commenter stated that the contact information for the Director or Delegate should be provided.

*HUD Response:* The Processing Guide has been revised in accordance with this comment.

## VI. Findings and Certifications

### *Regulatory Review—Executive Orders 12866 and 13563*

Under Executive Order 12866 (Regulatory Planning and Review), a determination must be made whether a regulatory action is significant and, therefore, subject to review by the Office of Management and Budget (OMB) in accordance with the requirements of the order. Executive Order 13563 (Improving Regulations and Regulatory Review) directs executive agencies to analyze regulations that are "outmoded, ineffective, insufficient, or excessively burdensome, and to modify, streamline, expand, or repeal them in accordance with what has been learned." Executive Order 13563 also directs that, where

relevant, feasible, and consistent with regulatory objectives, and to the extent permitted by law, agencies are to identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public. This rule was determined not to be a “significant regulatory action” as defined in section 3(f) of Executive Order 12866, nor was it found to be an economically significant regulatory action, as provided under section 3(f)(1) of the Executive Order.

This rule responds to the direction of Executive Order 13563 to reduce burden. As discussed in this preamble, HUD stakeholders have long complained about the previous participation process, and HUD has offered measures over the past to improve this process. However, these measures were not successful in providing a significant overhaul of the previous participation review process sufficient to remedy the common complaints. HUD believes that this final rule and accompanying Processing Guide strikes the appropriate balance between allowing HUD to effectively assess the suitability of applicants to participate in HUD’s multifamily housing and healthcare programs, while interjecting sufficient flexibility into the process in order to remove a one-size-fits-all review process. Such a balance best allows HUD to make determinations of suitability in order to accurately access risk.

#### *Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA) (5 U.S.C. 601 *et seq.*) generally requires an agency to conduct a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements, unless the agency certifies that the rule would not have a significant economic impact on a substantial number of small entities.

As has been discussed in this preamble, this rule streamlines HUD’s previous participation review process, responding to longstanding complaints by HUD participants that this is an overly burdensome process. The changes made by this final rule allow HUD to better consider the differences of any applicant and tailor requested information to that applicant, including whether the applicant is a small entity. For these reasons, HUD has determined that this rule would not have a significant economic impact on a substantial number of small entities.

#### *Environmental Impact*

This rule does not direct, provide for assistance or loan and mortgage

insurance for, or otherwise govern, or regulate, real property acquisition, disposition, leasing, rehabilitation, alteration, demolition, or new construction, or establish, revise or provide for standards for construction or construction materials, manufactured housing, or occupancy. Accordingly, under 24 CFR 50.19(c)(1), this rule is categorically excluded from environmental review under the National Environmental Policy Act of 1969 (42 U.S.C. 4321).

#### *Federalism Impact*

Executive Order 13132 (entitled “Federalism”) prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial direct compliance costs on state and local governments and is not required by statute, or preempts state law, unless the agency meets the consultation and funding requirements of section 6 of the Order. This rule does not have federalism implications and would not impose substantial direct compliance costs on state and local governments nor preempts state law within the meaning of the Order.

#### *Unfunded Mandates Reform Act*

Title II of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1531–1538) (UMRA) establishes requirements for federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments, and on the private sector. This rule does not impose any federal mandates on any state, local, or tribal governments, or on the private sector, within the meaning of UMRA.

#### *Paperwork Reduction Act*

The information collection requirements contained in this rule have been submitted to and approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) and assigned the following OMB control numbers—2502–0118 and 2502–0605

#### **List of Subjects in 24 CFR Part 200**

Administrative practice and procedure, Claims, Equal employment opportunity, Fair housing, Housing standards, Lead poisoning, Loan programs-housing and community development, Mortgage insurance, Organization and functions (Government agencies), Penalties, Reporting and recordkeeping requirements, Social security, Unemployment compensation, Wages.

Accordingly, for the reasons stated in the preamble above, and in accordance with HUD’s authority under 42 U.S.C.

3535(d), HUD amends 24 CFR part 200 as follows

### **PART 200—INTRODUCTION TO FHA PROGRAMS**

■ 1. The authority citation for 24 CFR part 200 continues to read as follows:

**Authority:** 12 U.S.C. 1702–1715z-21; 42 U.S.C. 3535(d).

■ 2. Revise subpart H to read as follows:

#### **Subpart H—Participation and Compliance Requirements**

Sec.

200.210	Policy.
200.212	Definitions.
200.214	Covered Projects.
200.216	Controlling Participants.
200.218	Triggering Events.
200.220	Previous Participation review.
200.222	Request for reconsideration.

#### **Subpart H—Participation and Compliance Requirements**

##### **§ 200.210 Policy.**

(a) *Regulations.* It is HUD’s policy that, in accordance with the intent of the National Housing Act (12 U.S.C. 1701 *et seq.*), and with other applicable federal statutes, participants in HUD’s housing and healthcare programs be responsible individuals and organizations who will honor their legal, financial and contractual obligations. Accordingly, as provided in this subpart, HUD will review the prior participation of Controlling Participants, as defined in § 200.212 and § 200.216, as a prerequisite to participation in HUD’s multifamily housing and healthcare programs listed in § 200.214.

(b) *Processing Guide.* The regulations in this subpart are supplemented by the Processing Guide for Previous Participation Reviews of Prospective Multifamily Housing and Healthcare Programs’ Participants (Guide), which is found on HUD’s Web site at [www.hud.gov](http://www.hud.gov). This Guide elaborates on the basic procedures involved in the previous participation review process. For any significant changes made to this Guide, HUD will provide advance notice and the opportunity to comment, providing a comment period of no less than 30 days.

##### **§ 200.212 Definitions.**

As used in this subpart:

*Commissioner* means the Assistant Secretary for Housing-Federal Housing Commissioner, or the Commissioner’s delegates and designees.

*Controlling Participant* means an individual or entity serving in a capacity for a Covered Project that makes the individual or entity subject to Previous Participation review under this

subpart, as further described in § 200.216.

*Covered Project* means a project in which the participation of a Controlling Participant is conditioned on Previous Participation review under this subpart, as further described in § 200.214.

*Previous Participation* means a Controlling Participant's previous participation in Covered Projects, and, if applicable, other federal, state and local housing programs, in accordance with the definition of Risk.

*Risk.* In order to determine whether a Controlling Participant's participation in a project would constitute an unacceptable risk, the Commissioner must determine whether the Controlling Participant could be expected to participate in the Covered Project in a manner consistent with furthering the Department's purposes. The Commissioner's review of Previous Participation shall consider compliance with applicable statutes, regulations and program requirements. The Commissioner must consider the Controlling Participant's previous financial and operational performance in Covered Projects that may indicate a financial or operating risk in approving the Controlling Participant's participation in the subject Triggering Event. At the Commissioner's discretion, as necessary to determine financial or operating risk and to the extent the Commissioner determines such information to be reliably available, the Commissioner may consider the Controlling Participant's participation and performance in any federal, state or local government program. The Commissioner may exclude any Previous Participation the Commissioner determines to be of limited value, unreliable or irrelevant in evaluating risk and/or any Previous Participation in which the Controlling Participant did not exercise, actually or constructively, control. Any information collection in connection with review of Previous Participation must follow all applicable requirements for information collection.

*Triggering Event* means an occurrence in connection with a Covered Project that subjects a Controlling Participant to Previous Participation review under this subpart, as further described in § 200.218.

#### § 200.214 Covered Projects.

The following types of multifamily and healthcare projects are Covered Projects subject to the requirements of this subpart, provided however that single family projects are excluded from the definition of Covered Projects:

(a) *FHA insured projects.* A project financed or which is proposed to be financed with a mortgage insured under the National Housing Act, a project subject to a mortgage held by the Secretary under the National Housing Act, or a project acquired by the Secretary under the National Housing Act.

(b) *Housing for the elderly or persons with disabilities.* Housing for the elderly financed or to be financed with direct loans or capital advances under section 202 of the Housing Act of 1959, as amended; and housing for persons with disabilities under section 811 of the Cranston-Gonzalez National Affordable Housing Act.

(c) *Risk Share projects.* A project that is insured under section 542(b) or 542(c) of the Housing and Community Development Act of 1992 (12 U.S.C. 17107 note).

(d) *Projects subject to continuing HUD requirements.* A project that is subject to a use agreement or any other affordability restrictions pursuant to a program administered by HUD's Office of Housing.

(e) *Subsidized Projects.* Any project in which 20 percent or more of the units now receive or will receive a subsidy in the form of:

(1) Interest reduction payments under section 236 of the National Housing Act (12 U.S.C. 1715z-1);

(2) Rental Assistance Payments under section 236 of the National Housing Act (12 U.S.C. 1715z-1);

(3) Rent Supplement payments under section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s); or

(4) Project-based housing assistance payment contracts under section 8 of the United States Housing Act of 1937 (42 U.S.C. 1437f) administered by HUD's Office of Housing.

#### § 200.216 Controlling Participants.

(a) *Definition.* Controlling Participants are those entities and individuals (i) serving as a Specified Capacity with respect to a Covered Project and (ii) the entities and individuals in control of the Specified Capacities. Each of the following capacities for a Covered Project is a "Specified Capacity:"

(1) An owner of a Covered Project;

(2) A borrower of a loan financing a Covered Project;

(3) A management agent;

(4) An operator (in connection with healthcare projects insured under the following section of the National Housing Act: Section 232 (12 U.S.C. 1715w) and section 242 (12 U.S.C. 1715z-7));

(5) A master tenant (in connection with any multifamily housing project

insured under the National Housing Act (12 U.S.C. 1701 *et seq.*) and in connection with certain healthcare projects insured under sections 232 or section 242 of the National Housing Act);

(6) A general contractor; and

(7) In connection with a hospital project insured under section 242 of the National Housing Act (12 U.S.C. 1715z-7), a construction manager;

(b) *Control of entities.* To the extent any Specified Capacity listed in paragraph (a) of this section is an entity, any individual(s) or entities determined by HUD to control the financial or operational decisions of such Specified Capacity shall also be considered Controlling Participants. Without limiting the foregoing and unless otherwise determined by HUD, the following individuals or entities shall be considered Controlling Participants:

(1) Individuals or entities with the ability to direct the day-to-day operations of a Specified Capacity or a Covered Project;

(2) Individuals or entities that own at least 25 percent of an entity that is a Specified Capacity;

(3) Individuals or entities with the ability to direct the entity to enter into agreements relating to the Triggering Event that necessitates review of Previous Participation, including without limitation individuals or entities that own at least 25 percent of entities determined to control an entity that is a Specified Capacity; and

(4) In connection with a hospital project insured under section 242 of the National Housing Act (12 U.S.C. 1715z-7), members of a hospital Board of Directors (or similar body) and executive management (such as the Chief Executive Officer and Chief Financial Officer) that HUD determines to have control over the finances or operation of a Covered Project.

(c) *Exclusions from definition.* The following individuals or entities are not Controlling Participants for purposes of this subpart:

(1) Passive investors and investor entities with limited liability in Covered Projects benefiting from tax credits, including but not limited to low-income housing tax credits pursuant to section 42 of title 26 of the United States Code, whether such investors are syndicators, direct investors or investors in such syndicators and/or investors;

(2) Individuals or entities that do not exercise financial or operational control over the Covered Project, a Specified Capacity or another Controlling Participant;

(3) Unless determined by HUD to exercise day-to-day control over the

operations or finances of a Specified Capacity or Covered Project, board members of a non-profit corporation who are not officers or otherwise part of the executive management teams of the non-profit;

(4) Mortgagees acting in their capacity as such; and

(5) Public housing agencies (PHAs).

#### **§ 200.218 Triggering Events.**

(a) Each of the following is a Triggering Event that may subject a Controlling Participant to Previous Participation review under § 200.220:

(1) An application for FHA mortgage insurance;

(2) An application for funds provided by HUD pursuant to a program administered by HUD's Office of Housing, such as but not limited to supplemental loans;

(3) A request to change any Controlling Participant for which HUD consent is required with respect to a Covered Project; or

(4) A request for consent to an assignment of a housing assistance payment contract under section 8 of the United States Housing Act of 1937 or of another contract pursuant to which a Controlling Participant will receive funds in connection with a Covered Project.

(b) The Commissioner may also require a review of a potential owner's Previous Participation in connection with a loan sale or other form of property disposition, including foreclosure sale. Notwithstanding anything contained in the regulations in this subpart to the contrary, any such review shall be in accordance with the terms, conditions, provisions and other requirements set forth by the Commissioner in connection with such loan sale or property disposition which may differ, in whole or in part, from the regulations in this subpart.

#### **§ 200.220 Previous Participation review.**

(a) *Scope of review.* (1) Upon the occurrence of a Triggering Event, as provided in § 200.218, the Commissioner shall review the Previous Participation of the relevant Controlling Participants in considering whether to approve the participation of the Controlling Participants in connection with the Triggering Event in accordance with the definition of Risk in § 200.212.

(2) The Commissioner will not review Previous Participation for interests acquired by inheritance or by court decree.

(3) In connection with the submittal of an application for any Triggering Event, applicants shall identify the Controlling Participants and, to the

extent requested by HUD, make available to HUD the Controlling Participant's Previous Participation in Covered Projects.

(b) *Results of review.* (1) Based upon the review under paragraph (a) of this section, the Commissioner will approve, disapprove, limit, or otherwise condition the continued participation of the Controlling Participant in the Triggering Event, in accordance with paragraphs (c) and (d) of this section.

(2) The Commissioner shall provide notice of the determination to the Controlling Participant including the reasons for disapproval or limitation. The Commissioner may provide notice of the determination to other parties as well, such as the FHA-approved lender in the transaction.

(c) *Basis for disapproval.* (1) The Commissioner must disapprove a Controlling Participant if the Commissioner determines that the Controlling Participant is suspended, debarred or subject to other restriction pursuant to 2 CFR part 180 or 2 CFR part 2424;

(2) The Commissioner may disapprove a Controlling Participant if the Commissioner determines:

(i) The Controlling Participant is materially restricted, including voluntarily, from doing business with HUD (other than the restrictions listed in paragraph (c)(1) of this section) or any other governmental department or agency if the Commissioner determines that such restriction demonstrates a significant risk to proceeding with the Triggering Event; or

(ii) The Controlling Participant's record of Previous Participation reveals significant risk to proceeding with the Triggering Event.

(d) *Alternatives to disapproval.* In lieu of disapproval, the Commissioner may:

(1) Condition or limit the Controlling Participant's participation;

(2) Temporarily withhold issuing a determination in order to gather more necessary information; or

(3) Require the Controlling Participant to remedy or mitigate outstanding violations of HUD requirements to the Commissioner's satisfaction in order to participate in the Triggering Event.

#### **§ 200.222 Request for reconsideration.**

(a) Where participation in a Triggering Event has been disapproved, otherwise limited or conditioned because of Previous Participation review, the Controlling Participant may request reconsideration of such determination by a review committee or reviewing officer as established by the Commissioner. Reconsideration decisions shall not be rendered by the

same individual who rendered the initial review.

(b) The Controlling Participant shall submit requests for such reconsideration in writing within 30 days of receipt of the Commissioner's notice of the determination under § 200.220.

(c) The review committee or reviewing officer shall schedule a review of such requests for reconsideration. The Controlling Participant shall be provided written notification of such a review; such notice shall provide at least 7 business days advanced notice of the reconsideration. The Controlling Participant shall be provided the opportunity to submit such supporting materials as the Controlling Participant desires or as the review committee or reviewing officer requests.

(d) Before making its decision, the review committee or reviewing officer will analyze the reasons for the decision(s) for which reconsideration is being requested, as well as the documents and arguments presented by the Controlling Participant. The review committee or reviewing officer may affirm, modify, or reverse the initial decision. Upon making its decision, the review committee or reviewing officer will provide written notice of its determination to the Controlling Participant setting forth the reasons for the determination(s).

Dated: October 4, 2016.

**Edward L. Golding,**

*Principal Deputy Assistant Secretary for Housing.*

Approved: October 5, 2016.

**Nani A. Coloretti,**

*Deputy Secretary.*

**Note:** The following appendix will not appear in the Code of Federal Regulations.

### **Appendix—Processing Guide for Previous Participation Reviews of Prospective Multifamily Housing and Healthcare Programs' Participants**

#### **Purpose**

This Processing Guide (Guide) supplements HUD's Previous Participation Review regulations in 24 CFR part 200, subpart H. The Guide defines Controlling Participants for previous participation review, new flag approval, and rejection guidance and flag protocols in federal programs of certain participants seeking to take part in multifamily housing and healthcare programs administered by HUD's Office of Housing. The Guide aids in clarifying and simplifying the process by which HUD reviews previous participation of participants that have decision making authority over their projects as one component of HUD's responsibility to assess financial and operational risk to projects in these programs.

Pursuant to 24 CFR part 200, subpart H, HUD will not make substantial changes to this Guide without providing a 30-day notice and an opportunity to comment to the public. However, HUD notes that many titles of HUD officials and other contact information are noted in this Guide for many purposes. By way of illustration and not limitation, HUD may update any reference to titles, email addresses, Web sites or other information regarding HUD officials in this Guide (whether such update is necessary because of changes to titles, responsibilities, personnel, reorganization or for any other reason) without providing notice and an opportunity for comment. HUD may make other non-substantial changes made to this Guide without notice and comment.

This Guide updates and clarifies previous procedures and supersedes outstanding policy and guidance concerning previous participation review found in previous Housing notices and in the following: Multifamily Accelerated Processing (MAP) Guide Handbook 4430.G, Multifamily Asset Management and Project Servicing Handbook 4350.1, Healthcare Mortgage Insurance Program Handbook 4232.1, and Mortgage Insurance for Hospitals 4615.1. HUD will incorporate elements of this Guide into these handbooks. In addition, the Guide supersedes the Previous Participation (HUD-2530) Handbook 4065.1.

*Applicability of the Previous Participation Review*

This Guide applies to Covered Projects administered by the Office of Multifamily Housing and the Office of Healthcare Programs, as listed in HUD's regulations in 24 CFR part 200 subpart H:

a. *FHA-Insured Projects.* A project financed or proposed to be financed with a mortgage insured under the National Housing Act, a project subject to a mortgage held by the Secretary under the National Housing Act, or a project acquired by the Secretary under the National Housing Act; these may include projects that are insured under the following sections of the National Housing Act: Sections 213, 220, 221(d)(3), 221(d)(4), 223(a)(7), 223(d), 223(e), 207/223(f), 232/223(f), 242/223(f), 231, 232, 232(i), 236, 241(a), 241(f) or 242;

b. *Housing for the elderly or persons with disabilities.* Non-insured projects that

include Section 202 Direct Loans or Section 202 or Section 811 Capital Advances;

c. *Risk-share projects.* Projects that are insured under sections 542(b) or 542(c) of the Housing and Community Development Act of 1992;

d. *Projects subject to continuing HUD requirements:* Projects subject to a use agreement or any other affordability restrictions pursuant to a program administered by HUD's Office of Housing; and

e. *Subsidized Projects.* Projects in which 20 percent or more of the units now receive or will receive a subsidy in the form of:

- Interest reduction payments under section 236 of the National Housing Act (12 U.S.C. 1715z-1);
- Rental Assistance Payments under section 236 of the National Housing Act (12 U.S.C. 1715z-1);
- Rent Supplement payments under section 101 of the Housing and Urban Development Act of 1965 (12 U.S.C. 1701s); or
- Project-based rental assistance pursuant to housing assistance payment contracts under Section 8 of the Housing Act of 1937. This includes projects converting to PBRA assistance pursuant to the Rental Assistance Demonstration (RAD). This does not include project-based assistance provided under the Housing Choice Voucher program administered by HUD's Office of Public and Indian Housing or project-based assistance provided under the McKinney Act, administered by HUD's Office of Community Planning and Development.

For the Sections 223(a)(7), 223(f), 241(a), 232(i) and 223(d) programs Controlling Participants are only subject to Previous Participation review if they were not previously approved to participate in that project (provided they have not changed roles in the project without prior approval).

*Change in Controlling Participants*

To the extent the program requirements (including without limitation any contractual documents) governing a Covered Project require HUD consent for a change in a Specified Capacity or other Controlling Participant, consent to such change is subject to Previous Participation review.

**Waiver Authority**

Program offices may waive any portion of this Guide that is not a regulatory

requirement, subject to an appropriate justification, as required by HUD for all waivers. HUD expects waivers to be rare and in response to unique circumstances meeting the intent of HUD's Previous Participation review regulations.

**Program Requirements**

The sections below outline who is subject to a Previous Participation review; the submission requirements and review procedures; considerations for approval and rejection; and the participant flagging process.

*A. Controlling Participants for Previous Participation Review Purposes*

*Submittal of Controlling Participants.* Previous Participation review is required for Controlling Participants. In connection with each Triggering Event, Lenders in insured projects and entities serving in the Specified Capacities listed below in non-insured projects shall provide to HUD a list of all Controlling Participants. As stated throughout this Guide, HUD makes the ultimate determination of who is deemed to be a Controlling Participant. In reviewing the information submitted or if circumstances change prior to final HUD approval of a Triggering Event, HUD may determine that other individuals or entities are Controlling Participants necessary to review. However, HUD providing final approval of a Triggering Event confirms that all Controlling Participants with respect to that Triggering Event have been properly identified to HUD's satisfaction. Unless HUD discovers that individuals or entities have not been properly disclosed in accordance with the organizational chart requirements listed in this Processing Guide, HUD shall not change a determination of whether or not an individual or entity is a Controlling Participant after providing final approval for a Triggering Event.

Controlling Participants are those entities and individuals (i) serving as a Specified Capacity with respect to a Covered Project and (ii) the entities and individuals in control of the Specified Capacities. At least one natural person must be identified as a Controlling Participant for each Specified Capacity. The chart below shows the Specified Capacities for the listed programs.

**SPECIFIED CAPACITIES**

	Multifamily Housing	Office of Residential Care Facilities	Office of Hospital Facilities
Borrower or Owner .....	X	X	X
Management Agent .....	X	X	X
Operator .....		X	X
General Contractor .....	X	X	X
Construction Manager .....			X
Master Tenant/Landlord .....		X	X

*Controlling Participants.* The entities serving as a Specified Capacity are

Controlling Participants of the Covered Project for the programs listed. In addition,

the individuals and entities determined by HUD to exercise financial or operational

control over these entities are also Controlling Participants. Controlling Participants require Previous Participation review and must complete Previous Participation review submissions. Any individual or entity who exercises financial or operational control of a Specified Capacity is considered to be a Controlling Participant and required to complete a Previous Participation review submission, unless excluded below. Controlling Participants include both entities and natural persons. If a Controlling Participant is an entity, the submission must include the people who exercise the day-to-day financial or operational control for that entity. Notwithstanding the foregoing or anything else in this Guide, if HUD determines that an individual or entity does not actually exercise financial or operational control of a Covered Project or Specified Capacity, such individual or entity shall not be considered a Controlling Participant.

*List of Controlling Participants:* For purposes of Previous Participation review, unless excluded below or otherwise determined by HUD not to be a Controlling Participant, the following shall be considered to exercise financial or operational control over the listed entities and shall be considered Controlling Participants:

1. Entities and individuals owning, directly or indirectly, 25% or more of a Specified Capacity.

2. The controlling owners (entities and/or individuals) of the entity that controls the Specified Capacity, these include individuals or entities with the ability to direct the Specified Capacity to enter into agreements relating to the Triggering Event, including without limitation individuals or entities that own at least 25 percent of entities determined to control an entity that is a Specified Capacity.

3. Any officers and other equivalent executive management (including Executive Director and other similar capacities) of the Specified Capacity or Controlling Participant who are directly responsible to the board of directors (or equivalent oversight body) and who have the ability to prevent or resolve violations or circumstances giving rise to flags related to the Covered Project.

4. Managers or managing members of Limited Liability Companies (LLCs).

5. General partners of limited partnerships, including "administrative" general partners or other general partners if they exercise day-to-day control over the entity.

6. Partners in a general partnership.

7. Executive Director (or equivalent position) of a non-profit corporation.

8. With respect to non-profit Borrowers under the Section 242 program, the executive management (Chief Executive Officer, Chief Financial Officer, and Chief Operating Officer, or equivalents) of the Borrower and the members of the Board of Directors that HUD determines have control over the finances or operation of the hospital (typically the President, Vice President, Treasurer, and Chairman of the Finance Committee, or equivalents).

9. Members of a for-profit corporation's Board of Directors who are also officers of the corporation.

10. Controlling stockholders of a corporation. A controlling stockholder is the holder of sufficient voting stock or shares in a corporation to prevail in any stockholders' motion. In most cases the controlling stockholder will be subject to the previous participation filing requirements of those owning at least 25% of a Specified Capacity or Controlling Participant. However, this listing is meant to trigger filing requirements for shareholders who may technically evade the 25% ownership filing requirement but exercise financial or operational control over the Specified Capacity.

11. Trustees of a trust.

12. For real estate investment trusts (REITs), the REIT itself, the chief executive officer (or equivalent position) and all company officers (except those officers determined by HUD not to exercise day-to-day control over the REIT, the Specified Capacity or the Covered Project) must file.

13. For insured projects, if applicable, the person (people) and/or entity (entities) to be listed on the Regulatory Agreement Non-Recourse Debt section.

14. Any other person or entity determined by HUD to exercise day-to-day, financial or operational control over a Specified Capacity. While it is unlikely, this may include any officers, directors or members of an executive management team who would otherwise not be required to make a submission (even of shell entities or other entities that may fall into the exclusions below), if such person is exercising control over the Specified Capacity. This listing is meant to capture those rare individuals who structure their participation so as to technically circumvent HUD requirements but who de facto exercise control over the Specified Capacity. HUD believes that the individuals and entities described in the list above accurately account for the Controlling Participants in the vast majority of cases and that invoking an additional submission through this catch-all listing should be rare.

If the applicant or Mortgagee has any reason to believe that any Controlling Participant is not of sound mind or body or is otherwise incapacitated, such information must be disclosed to HUD to review and determine whether another individual is acting as a Controlling Participant.

*List of Exclusions:* Except that any Specified Capacity is a Controlling Participant, and unless otherwise determined in writing by HUD in a specific transaction to exercise day-to-day control of a Covered Project or Specified Capacity, Controlling Participants do not include the following:

1. *Wholly-owned entities.* Any entity that is 100% owned or controlled by one individual or entity is excluded. Such entities are not exercising control; the individual or entity that wholly owns them is exercising control. An organizational chart may include one or more tiers of wholly-owned entities. All wholly-owned entities in all tiers are excluded.

2. *Shell entities.* Entities that do not take actions themselves but only serve as legal vehicles through which the partners, members or owners of such entity take actions are excluded. These entities are not exercising control; the partners, members or

owners of such entities are controlling. The "middle tiers" of an organizational chart are often shell entities.

For example, if a Borrower ("Borrower LLC") has a managing member ("Managing Member") that is a joint venture partnership of two entities ("Partner 1" and "Partner 2") and day-to-day control of Managing Member is exercised by Partner 1, then Partner 1 is the Controlling Participant of the Borrower. In this example, neither Managing Member nor Partner 2 are actually exercising control and are excluded. If Partner 1 is itself a shell LLC, with three members, then the individual(s) or entity(ies) that exercise day-to-day control of Partner 1 would be the Controlling Participant(s). If day-to-day control of Partner 1 is exercised by Member A, then Partner 1 would be excluded and Member A would be the Controlling Participant. If the organizational chart reflects this arrangement and unless additional information or special circumstances warrant further inquiry, HUD will accept Member A's certification that it is the Controlling Participant and will not require an examination of the various entities' organizational documents to confirm that Managing Member and Partner 1 are excluded shell entities.

3. *Tax credit investors.* Syndicator and direct investor entities in Low-Income Housing Tax Credits, Historic Tax Credits, New Markets Tax Credits or other tax credits (if HUD determines such credits are substantially similar to the listed tax credits) are excluded unless such entities exercise day-to-day control or seek other involvement that would trigger the need for previous participation review. HUD may still require a so-called "LLCI certification," an "Identification and Certification of Limited Liability Investor Entities," "Passive Investor Certification" or any other such certification. Acceptable language for such certification is attached as an addendum to this Guide.

4. *Passive participants.* If an entity's organizational documents specify which members, partners or owners are authorized to exercise day-to-day control of that entity, then any other members, partners or owners who are not authorized to exercise day-to-day control of an entity are excluded.

5. *Minor officers.* If HUD determines that an officer of a corporation or other entity does not have significant involvement in a Covered Project, such officers are excluded. Typically, "significant involvement" means an ability to prevent or resolve violations or circumstances giving rise to flags related to the Covered Project.

In the event HUD requests an officer who has not provided a Previous Participation Review submission to provide a submission, HUD shall accept certification from the officer that (s)he has limited involvement in the Covered Project, does not exercise operational or financial control over the Covered Project and does not have the ability to prevent or resolve violations or circumstances giving rise to flags related to the Covered Project (as listed below in Section G, "Flags").

6. *Members of a Board of Directors.* Members of a non-profit or for-profit corporation's board of directors who do not



exercise control over the corporation in another capacity (for example, as Executive Director or other manager or officer of the non-profit corporation) are excluded. This exclusion does not apply to the members of boards of directors of hospitals, the rule for which is specified in the Regulation and captured in #8 within the Listing of Controlling Participants above.

7. *Less than 25% ownership interest.* Unless exercising control through another capacity, members, partners, stakeholders and owners of entities with less than a 25% interest in an entity are excluded. This exclusion does not apply to any such member, partner, stakeholder or other owner of an entity (“Proposed Excluded Member”) who would have an interest greater than 25% if the combined percentages of all other members, partners, stakeholders or other owners (including beneficial interests in trusts) with whom the Proposed Excluded Member has an “Identity of Interest,” or a conflict of interest because of familial relation or common financial interest, exceeds 25%. Whether an Identity of Interest or conflict of interest exists is determined by HUD. If the program requirements of the applicable program in which the Covered Project is participating speak to Identify of Interest or conflict of interest, those program requirements control.

8. *Nursing Homes and Assisted Living Facilities.* With respect to projects under the Section 232 program, the nursing home administrator and equivalent positions in assisted living facilities are excluded.

9. *Publicly Held Companies.* For publicly held companies, the chief executive officer (or equivalent position), the controlling shareholder (if any), and other individual(s), if any, identified as having day-to-day control over a Specified Capacity or Covered Project, including any relevant project manager(s), must file but the publicly held company shall otherwise be treated as an individual without need for other individual shareholders to file certifications in their individual capacity or identify their social security or tax identification numbers.

10. *Mortgagees.* Mortgagees acting in their capacity as such are excluded.

11. *Public housing agencies.* Public housing agencies, whether in their capacity as owning and operating public housing or otherwise, are excluded. Public housing agencies are subject to different oversight and review by HUD’s Office of Public and Indian Housing.

12. *No Exercise of Financial or Operational Control.* Any individual or entity determined by HUD not to exercise financial or operational control of a Covered Project or

Specified Capacity shall not be considered a Controlling Participant.

*B. Organization Charts*

An organization chart must be submitted for each Specified Capacity and for any entity within the organization chart if requested by HUD. Organization charts are visual representations of the ownership structure of an organization. Organizational charts are already required for the underwriting purposes as a part of the application or request for most Triggering Events. This Guide clarifies that such organizational charts shall also be submitted with the Previous Participation review submissions for the purposes of Previous Participation review. If the application or request for a Triggering Event does not otherwise require submission of organizational charts, this Guide clarifies that such organizational charts are required for purposes of Previous Participation review. All organization charts submitted in connection with a Triggering Event are considered part of the application for HUD review and subject to the certifications stating that the application is true and complete. The organization chart must be clear enough so that a person unfamiliar with the Covered Project and the entities involved can understand the ownership and control structure. The organization chart must comply with the following guidelines:

1. Clearly show all tiers of the ownership structure, including the members or owners of the entities listed.
2. Show all participants, not just those who the Lender or Applicant considers to be principals or Controlling Participants. HUD may accept an organizational chart without a full listing of all participants if HUD determines that such a listing would be unduly burdensome.
3. Show percentages of ownership and role in the entity (e.g. Limited Partner, General Partner, Managing Member, Tax Credit Syndicator/Investor, etc.). The percentages must add to 100%. However, if there are more than 10 holders of an ownership interest in an entity, no one with less than a 10% interest must be individually disclosed. In that case, holders with less than a 10% ownership interest in the entity may be listed as a group by indicating the total percentage of ownership interests held by the group and the total number of members of the group (e.g., “8 members own portions of the remaining 12%”). For public companies, shareholders holding less than 10% interest can be grouped by indicating the aggregate percentage and identified as “widely held” (e.g., “80% of shares are widely held”). To the extent ownership interests are aggregated,

the Applicant must provide any information requested by HUD regarding such interests.

4. List at least one natural person, not just entities; provided, however, tax credit investors and other investors that are not exercising day-to-day control are not required to list a natural person.

5. Provided that nothing in this Guide is meant to alter any underwriting requirements, for purposes of Previous Participation review, with respect to tax credit investors and other investors that are not exercising day-to-day control over a Specified Capacity or Controlling Participant, only the investor entity and its percentage ownership in the Specified Capacity need be shown; it is not necessary to show the members, partners or owners of the investor entity. HUD notes that additional information relating to investors may be required separately through underwriting review.

6. Each Specified Capacity must be shown on a separate organization chart (e.g. Borrower, Operator, Management Agent, Master Tenant, etc.).

7. With respect to each entity on the organization chart except wholly owned entities, tax credit investors and other investors that are not exercising day-to-day control, the executive management teams (for example, all senior officers such as CEO, CFO, President, Executive Director, etc., but not department heads or lower level management) and any members of a Board of Directors must be disclosed to HUD even if such individuals are not considered to be Controlling Participants and do not need to file Previous Participation review submissions. Such information must be updated if it changes prior to the Triggering Event. HUD may accept an organizational chart without a full listing of an entity’s Board of Directors if HUD determines that such a listing would be unduly burdensome.

*C. Filing the Previous Participation Certification*

(1) To fulfill the Previous Participation review requirements, applicable controlling participants must file a Previous Participation Certification. The Previous Participation review shall occur concurrently with the review of the application for mortgage insurance or other request for approval of a Triggering Event. Participants may utilize either the electronic Active Partners Performance System (APPS) or a paper alternative. Participants should not file both an APPS submission and a paper form. HUD strongly encourages participants to utilize the APPS system.

The following chart indicates which filing options are available for which programs.

Filing method	Multifamily Housing & Grant Administration projects	Office of Residential Care Facilities	Office of Hospital Facilities
Active Partners Performance System (APPS) Submission .....	X	X	X
<b>OR</b>			
Form HUD-2530 (paper) .....	X	.....	X

Filing method	Multifamily Housing & Grant Administration projects	Office of Residential Care Facilities	Office of Hospital Facilities
Consolidated Certification <sup>9</sup> Previous Participation Section (paper) .....	.....	X	.....

(2) It is the participant's responsibility to ensure that the filing is correct, complete and accurate. The participant should ensure compliance with the certifications is met. In rare instances, if there is a certification that the Controlling Participant cannot certify to, the participant must strikethrough that certification and provide a signed letter of explanation.

(3) As part of the Previous Participation Certification, participants are only required to list all projects which they have participated in over the previous 10-year

period. However, to the extent HUD has information that precedes the previous 10 years, HUD reserves the right to review and consider a participant's Previous Participation in federal projects beyond the 10-year period when determining whether to approve participation in a Triggering Event. Controlling Participants must include all previous participation from the past 10 years in: (a) Covered Projects, (b) housing projects with current flags under the U.S. Department of Agriculture's previous participation review system and (c) any other housing

project participating in a federal, state or local or government program if during the Controlling Participant's participation in the housing project (i) the housing project was foreclosed upon; (ii) the housing project was transferred by a deed in lieu of foreclosure; or (iii) an event of default, or similarly termed event, was declared and remained after any applicable notice and cure periods against the housing project or the Controlling Participant pursuant to the government program's project documents.

**ACTIVE PARTNERS PERFORMANCE SYSTEM (APPS) SUBMISSION INSTRUCTIONS**

HUD has made several upgrades to the system to improve the applicant submission process. For example, HUD now allows for electronic signatures of APPS submissions, ability to upload submission packages, and has improved the baseline submission to allow for edits. HUD encourages participants to utilize the APPS system when filing the Previous Participation Certification as it saves a substantial amount of time and allows for faster review of submissions by HUD reviewers.

Here is a link to the APPS resources: [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/mfh/apps/appsmfthm](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/apps/appsmfthm).

For questions about the APPS system contact the Multifamily Housing Systems Help Desk by phone at (800) 767-7588 or [Apps-F24p@hud.gov](mailto:Apps-F24p@hud.gov).

Step 1: System Registration .....	This step registers Controlling Participants in the APPS system. See the APPS Quick Tips for detailed instructions on the registration process: <a href="http://portal.hud.gov/hudportal/documents/huddoc?id=appsquicktips.pdf">http://portal.hud.gov/hudportal/documents/huddoc?id=appsquicktips.pdf</a> .
Step 2: Create a Baseline .....	This step establishes the organizational structure and previous participation of Controlling Participants. See Chapter 2 of the APPS Userguide for specific instructions and screen shots: <a href="http://portal.hud.gov/hudportal/documents/huddoc?id=chapter2.pdf">http://portal.hud.gov/hudportal/documents/huddoc?id=chapter2.pdf</a> .
Step 3: Create a Property Submission.	This step creates a submission for a Controlling Participant's role in a specific project. See Chapter 3 of the APPS Userguide for specific instructions and screen shots: <a href="http://portal.hud.gov/hudportal/documents/huddoc?id=chapter3.pdf">http://portal.hud.gov/hudportal/documents/huddoc?id=chapter3.pdf</a> .
Step 4: Complete the Certification and Submit to HUD.	In this step Controlling Participants electronically certify to previous participation certifications and send the submission to HUD for review. See the discussions above regarding what projects must be included and if there is a certification the Controlling Participant cannot certify to. See also Chapter 7 of the APPS Userguide for specific instructions and screen shots: <a href="http://portal.hud.gov/hudportal/documents/huddoc?id=CHAPTER7.PDF">http://portal.hud.gov/hudportal/documents/huddoc?id=CHAPTER7.PDF</a> .
Step 5: Upload the Organization Chart with the Signature Pages.	The user uploads the Organization Chart and Signature Pages into the APPS system. See Section B for a description of what the organization chart must include.

**FORM HUD-2530 COMPLETION INSTRUCTIONS<sup>10</sup>**

*[It is the participant's responsibility to assure that the Form HUD-2530 is correct, complete and accurate]*

Form section	Instructions
Review certification language .....	The participant should assure that compliance with the certification is met. See the discussion above if there is a certification the Controlling Participant cannot certify to.
Block 2 .....	List Project Name and Number.
Block 7 .....	Controlling Participants on the organization chart must match Block 7.
Blocks 8 and 9 .....	Write "See Organization Chart".
Block 10 .....	Insert Social Security Number or Tax ID Number for each Controlling Participant.
Bottom of Page 1 .....	The Controlling Participants listed in Block 7 must also be listed in the signature block at the bottom of Page 1.
The Controlling Participants must sign and date the submission.	The Controlling Participants must sign and date the submission. Authorized person(s) may sign on behalf of other person(s) or entities. It is the signer's responsibility to assure that they are authorized to sign on behalf of others. Each signature block must include a signature.
Schedule A .....	All principals listed in Block 7 must be listed in Column 1.
Column 2 .....	Column 2 must include all previous participation from the past 10 years. See discussion above regarding what projects must be included.

<sup>9</sup> Consolidated Certifications are the following forms: HUD 90013-ORCF, Consolidated Certification-Borrower, HUD 90014-ORCF,

Consolidated Certification-Principal of the Borrower, HUD 90015-ORCF, Consolidated Certification-Operator, HUD 90017-ORCF,

Consolidated Certification-Management Agent, and HUD 90018-ORCF, Consolidated Certification-General Contractor.

FORM HUD-2530 COMPLETION INSTRUCTIONS <sup>10</sup>—Continued

[It is the participant's responsibility to assure that the Form HUD-2530 is correct, complete and accurate]

Form section	Instructions
Column 3 Principal Role .....	Controlling Participants with No Previous Participation should write "No Previous Participation, First Experience."
Column 4 Loan Status .....	Principal roles must be included in Column 3. The Status of the Loan must be listed in Column 4. Note: This section is not applicable for General Contractors that did not have ownership interest in the project.
Column 5 .....	Identify (check box) whether the project was ever in default during the participant's participation in Column 5. If the "yes" box is checked a detailed explanation of the circumstances (including mitigating factors) must be provided. Note: This section is not applicable for General Contractors that did not have ownership interest in the project.
Column 6 .....	List the latest Management Review and Physical Inspection dates and scores in Column 6. If there are no scores, write "None." Note: This section is not applicable for General Contractors that did not have ownership interest in the project.
Business Partner Registration System (BPRS) Registration.	Each Controlling Participant must be registered in the BPRS System. Here is a link: <a href="https://hudapps2.hud.gov/apps/part_reg/apps040.cfm">https://hudapps2.hud.gov/apps/part_reg/apps040.cfm</a> .
Organization Chart .....	Attach an organization chart. See Section B for a description of what the organization chart must include.

CONSOLIDATED CERTIFICATION COMPLETION INSTRUCTIONS

[It is the participant's responsibility to assure that the Consolidated Certification is correct, complete and accurate]

Form section	Instructions
Review certification language in the Consolidated Certification.	The participant should assure that compliance with the certification is met.
Attachment 1 .....	Participants with Previous Participation must complete Attachment 1 of the Consolidated Certification for projects participated in over the past 10 years. See discussion above regarding what projects must be included.
Business Partner Registration System (BPRS) Registration.	Each Controlling Participant must be registered in the BPRS System. Here is a link: <a href="https://hudapps2.hud.gov/apps/part_reg/apps040.cfm">https://hudapps2.hud.gov/apps/part_reg/apps040.cfm</a> .
Organization Chart .....	Attach an organization chart with Social Security Numbers or Tax ID numbers for Controlling Participants. See Section B for a description of additional items the organization chart must include.

D. Approval of Participants

If there are no flags in the system and the applicant is able to make all the certifications or HUD has approved any reason as to why a certification cannot be made, the Previous Participation review is considered complete and the submission will be approved.

If there are current flags in the system, HUD staff will review:

- The comments in the system related to the flag.
- The lender or participant's explanation of the flag and any mitigation of risk associated with the flag.
- Whether flags need to be resolved.
- The flag history in the system to assess patterns of misconduct and risk to the Department.

Based upon this review, including review of the certifications, HUD will determine whether or not the Controlling Participant poses an unacceptable Risk to the Covered Project, in accordance with the definition in 24 CFR 200.212, namely whether the Controlling Participant could be expected to

participate in the Covered Project in a manner consistent with furthering the Department's purposes. Based on this determination, HUD may approve, disapprove, limit or otherwise condition the continued participation of the Controlling Participant in the Triggering Event.

Disapproval is only appropriate in the relatively few cases where the risks present cannot be mitigated. HUD will disapprove a Controlling Participant if the Controlling Participant is suspended, debarred or subject to other restriction pursuant to 2 CFR part 180 or 2 CFR part 2424. HUD may disapprove a Controlling Participant if HUD determines: (i) The Controlling Participant is materially restricted, including voluntarily, from doing business with HUD (other than the restrictions listed above) or any other department or agency of the federal government if the Commissioner determines that such restriction demonstrates a significant risk to proceeding with the Triggering Event; or (ii) HUD determines that the Controlling Participant's record of Previous Participation reveals significant risk

to proceeding with the Triggering Event that cannot be adequately mitigated.

In lieu of disapproval, HUD may (1) condition or limit the Controlling Participant's participation; (2) temporarily withhold issuing a determination in order to gather more necessary information; or (3) require the Controlling Participant to remedy or mitigate outstanding violations of HUD requirements to the Commissioner's satisfaction in order to participate in the Triggering Event. A remedy or mitigation may include resolving any underlying issues that caused the existing flags or other measures that demonstrate to HUD's satisfaction that the Controlling Participant could be expected to participate in the Covered Project in a manner consistent with furthering the Department's purpose of supporting and providing decent, safe and affordable housing for the public.

In accordance with these provisions, if a HUD official approves a participant's participation while a flag remains outstanding, the determining HUD official shall annotate the APPS system with a

<sup>10</sup> Until further notice, if using the paper Form HUD-2530, use these instructions.

comment to the outstanding flag keeping a record of why approval is warranted and what, if any, conditions were imposed. The participant shall receive written notification of such determination and such explanatory comments. The purpose of this record is to

prevent a repetitive HUD review in the future. If the circumstances and risks related to a flag have been determined by HUD to be mitigated, such risks and circumstances shall also be deemed mitigated and approval shall be approved under similar conditions, if any,

for future Triggering Events, unless additional violations are present, circumstances have changed or additional information has come to light.

**HUD OFFICES & OFFICIALS RESPONSIBLE FOR APPROVAL OF PARTICIPANTS WITH FLAGS**

	Office of Multifamily Housing & Assisted Housing Oversight Division, 220, 221(d)(4), 223(a)(7), 223(f), 231, 241(a) programs		Office of Residential Healthcare Facilities	Office of Hospital Facilities
	Production	Asset management		
Participants with Tier 1 Flags.	Director of Multifamily Housing Production (HQ).	Director, Office of Asset Management and Portfolio Oversight (HQ).	Director, Office of Residential Care Facilities or Delegate.	Director, Office of Hospital Facilities.
Participants with Tier 2 Flags.	Production Division Director.	Asset Management Division Director.	Supervisory Account Executive.	Director, Office of Hospital Facilities.
Participants with Tier 3 Flags.	Branch Chief		Supervisory Account Executive.	Director, Office of Hospital Facilities.

*E. Disapproval of Participants*

If a recommendation for disapproval is proposed, HUD staff will notify the participant, and, in the case of an FHA-

insured loan, the Lender, in advance of the recommendation, which notification shall include the basis for the anticipated disapproval and, if known, what information is needed to resolve HUD's concerns. This

notification will allow an opportunity for the participant to provide additional arguments for HUD's consideration to preserve processing efficiency and cut down on requests for reconsideration.

**HUD OFFICES & OFFICIALS RESPONSIBLE FOR REJECTION OF PARTICIPANTS WITH FLAGS**

	Office of Multifamily Housing & Assisted Housing Oversight Division, 220, 221(d)(4), 223(a)(7), 223(f), 231, 241(a) programs		Office of Residential Healthcare Facilities	Office of Hospital Facilities
	Production	Asset management		
Participants with Tier 1, Tier 2 or Tier 3 Flags.	Regional Director or Delegate.	Division Director, Office of Residential Care Facilities or Delegate.	Division Director, Office of Hospital Facilities.	

*F. Reconsideration of a Disapproval*

Participants have the right to request a reconsideration of HUD decisions disapproving participants. The Controlling Participant shall submit requests for such reconsideration in writing within 30 days of receipt of HUD's notice of disapproval. The review committee or reviewing officer shall schedule a review of such requests for reconsideration. The Controlling Participant shall be provided written notification of such a review at least 7 business days in advance of the reconsideration. The reconsideration shall not occur prior to the date provided to the Controlling Participant so that the

Controlling Participant shall be provided the opportunity to submit such supporting materials as the Controlling Participant desires or as the review committee or reviewing officer requests. However, reconsideration need not be conducted through a formal meeting and the Controlling Participant may not necessarily have an opportunity to appear before the reviewing official in person.

Before making its decision, the review committee or reviewing officer will analyze the reasons for the decision(s) for which reconsideration is being requested, as well as the documents and arguments presented by

the Controlling Participant. The review committee or reviewing officer may affirm, modify, or reverse the initial decision. Upon making its decision, the review committee or reviewing officer will provide written notice of its determination to the Controlling Participant setting forth the reasons for the determination(s). Reconsideration decisions shall not be rendered by the same individual who rendered the initial review. Please see the below table for the officials responsible for rendering reconsideration decisions applicable to each program area. The decision rendered by the officials below is final agency action.

**HUD OFFICES & OFFICIALS RESPONSIBLE FOR RECONSIDERATION OF A REJECTION**

Office of Multifamily Housing & Assisted Housing Oversight Division	Office of Healthcare Programs	
	Office of Residential Healthcare Facilities	Office of Hospital Facilities
Director, Office of Asset Management and Portfolio Oversight or Delegate.	Director, Office of Residential Care Facilities or Delegate.	Director, Office of Hospital Facilities or Delegate.

*G. Flags*

HUD utilizes flags in the APPS system as a way to assess risk associated with participants in Office of Multifamily Housing

and Office of Healthcare Programs projects. A flag does not automatically exclude an applicant from participation in HUD's programs; however, flags are considered risk factors that require appropriate mitigation,

where possible. Flags are to be a meaningful representation of risk, and therefore, they should not be placed for minor infractions that do not pose a risk to HUD. HUD will

notify participants in writing when flags are placed.

1. *Placement of Flags.* When there is a violation or other circumstance warranting a flag in connection with a Covered Project, as listed in the charts below, HUD shall place a flag on all Controlling Participants who contributed to the violation or circumstance or failed to intervene appropriately but shall not place a flag on any Controlling Participant determined by HUD not to have contributed to the violation or circumstance (or if it is otherwise determined by HUD that placement of a flag on such Controlling Participant would be inappropriate). HUD shall not place any flags on Controlling Participants in connection with violations that occur prior to the Controlling Participant's involvement in the Covered Project. HUD shall not place flags relating to ongoing violations on Controlling Participants who become involved with a Covered Project with HUD's consent in order to mitigate or remedy the ongoing violation, provided that HUD may place flags on such a Controlling Participant related to new violations occurring after the Controlling Participant has become involved with the Covered Project.

For the Office of Multifamily Housing & Assisted Housing Oversight Division, Tier 1 and 2 manual flags must be reviewed by the Branch Chief prior to placement. For the Office of Healthcare Programs, all manual

flags must be reviewed by the Director of Asset Management prior to placement. The Branch Chief and Director of Asset Management, respectively, shall ensure that their office's Account Executive notifies the flagged participant of the flag placement and provides adequate comments in the APPS system detailing the reason for the flag.

For any flag, if the Branch Chief or Director of Asset Management has reason to believe that placement of the flag is inappropriate, the Branch Chief and/or Director of Asset Management may approve removal of the flag or no placement of the flag in the first place. For example, HUD is aware that currently, when an owner purchases a portfolio, HUD's Financial Assessment of Multifamily Housing (FASS) system may have trouble accepting the financial statement submission of the new owner. In this circumstance, the system may perceive the new owner as having multiple failures to file financial statements because each property in the portfolio may be perceived as missing a financial statement. In this circumstance, the system may indicate that a Tier 2 flag would be appropriate, but obviously no flag is warranted. In this circumstance, the Account Executive shall not place a flag on the Controlling Participant's record or shall remove any such unwarranted flag relating to such circumstance. The Branch Chiefs and Directors of Asset Management have

authority to make similar determinations in other circumstances.

2. *Tiers of Flags.* HUD has developed three flag tiers, which reflect varying levels of risk to HUD. Tier 1 flags are elevated risk to HUD. HUD considers Tier 1 flags to be a significant long-term risk to HUD and warrant significant mitigation in new transactions. Tier 2 flags are considered an ongoing risk to HUD. For Tier 2 flags that have a resolution date (as listed in the chart below), flags will not be removed until the time period has expired even if the action has been resolved earlier. This is considered a risk factor in production and asset management transactions. Tier 3 flags are considered a single risk to HUD and will be removed when the reason for the flag is corrected.

*Tier 1 Flags: Elevated Risk to the Department*

Tier 1 flags warrant permanent consideration when reviewing Controlling Participants for their participation in Triggering Events. Except that HUD will disapprove a Controlling Participant if the Controlling Participant is currently suspended, debarred or subject to other restriction pursuant to 2 CFR part 180 or 2 CFR part 2424, participants with Tier 1 flags may still participate in a Triggering Event if the risk posed by the flag has been appropriately mitigated.

Tier 1 Flags:

Flag type	Reason	Duration of flag
Mortgage Assignment/Conveyance of Title .....	Mortgagee assigned title or conveyed property to HUD .....	Permanent flag.*
FHA Claim or Partial Payment of Claim .....	Claim payment by HUD .....	Permanent flag.*
HUD Property Disposition .....	Foreclosure, loan sale, or other property disposition effort by HUD.	Permanent flag.*
Mortgagee in Possession (MIP) .....	HUD becomes the MIP .....	Permanent flag.*
Deed in Lieu of Foreclosure .....	HUD receives a deed in lieu of foreclosure .....	Permanent flag.*
Limited Denial of Participation (LDP)—Current or Past.	Participant is currently or has previously been placed on the LDP list.	Permanent flag.
Suspension or Debarment—Current or Past .....	Participant is currently or has previously been placed on the Debarment list or the participant is or was temporarily suspended from participation in HUD programs.	Permanent flag.
Voluntary Abstention or Exclusion—Current or Past	Participant is currently or has previously been subject to a voluntary abstention from participation in HUD programs.	Permanent flag.
Conviction for fraud or embezzlement of funds .....	Participant has been convicted of fraud or embezzlement of funds.	Permanent flag.

**Participants with Tier 1 flags may be approved if:**

Participants with Tier 1 flags may be approved if:

1. The participant is not currently suspended, debarred or subject to other restriction pursuant to 2 CFR part 180 or 2 CFR part 2424;
2. HUD determines that, because the participant has sufficiently improved operations and oversight to ensure that further violations will not occur or for other compelling reasons, the flag is not indicative of ongoing risk.

Questions that may be relevant to this analysis include:

- What has the participant done to mitigate the risk indicated by the flag?
- Is the flagged condition indicative of a current pattern of behavior? What has the participant done to change the underlying causes of the flagged condition or otherwise prevent the flagged condition from occurring again?
- Is the flagged condition limited in number and/or geography relative to the participant's whole portfolio? Was the flagged condition an isolated event?
- Has significant time passed since the condition was flagged?
- Was the flagged condition caused by market or other forces outside the participant's control?
- How does the participant's role in the flagged condition compare to his/her role in the Triggering Event and Covered Project for which they are currently seeking approval?

\* Unless otherwise determined by HUD due to mitigating circumstances.

*Tier 2 Flags: Compliance Risk to the Department*

Tier 2 flags warrant consideration for an extended period of time when reviewing

Controlling Participants for their participation in Triggering Events, even after the underlying reason for the flag is resolved. A "Repeated" Offense means that a

Controlling Participant has had three or more instances of the violation in a seven-year period.

Flag type	Explanation	Duration of flag
Repeated Failure to File Annual Financial Statements.	Repeated Failure to File Annual Financial Statements (three or more occurrences in a seven-year period).	Retained until there have been five (5) years with no missed filings of Annual Financial Statements.
Default-Financial .....	60 days or more behind on loan payments .....	Retained for five (5) years after the placement date of the flag.
Unacceptable Physical Condition of a property	A property received a Real Estate Assessment Center (REAC) score below 30, two consecutive REAC scores below 60, Repeated REAC scores below 60, or other Repeated failures to maintain decent, safe and sanitary conditions.	May be removed upon the completion of a five (5) year period in which the property receives no REAC score below 60.
Unauthorized Distributions .....	Repeated incidents of Unauthorized Distributions.	Retained for five (5) years after the placement date of the flag.
Repeated Unresolved Audit Findings .....	Repeated Unresolved Audit Findings .....	Retained for five (5) years after the placement date of the flag provided that audit findings have been resolved.
Conversion to Unapproved Use .....	Project was converted to a use that is not permitted under the program obligations.	Retained for five (5) years after the placement date of the flag.
Unauthorized Alteration to Facility .....	Project or part of the project completed a significant addition/alteration/construction/licensure status without prior approval.	Retained for five (5) years after the placement date of the flag.
Unauthorized Change in Participant .....	When a Transfer of Physical Assets (TPA), Change of Management Agent, Lessee or other change of Controlling Participant requiring HUD consent is completed without prior HUD approval.	Retained for five (5) years after the placement date of the flag.
Unauthorized Secondary Financing .....	When Secondary Financing is utilized without prior HUD approval.	Retained for five (5) years after the placement date of the flag.
Miscellaneous Violation of Business Agreements.	Repeated violations of business agreements (e.g., breaking use agreement or affordability restrictions, repeated unacceptable management reviews, repeated failure to comply with an action plan, non-compliance with program requirements, non-responsive to HUD requests).	Retained for five (5) years after the placement date of the flag.
Suspension/Termination of Payments .....	When HUD suspends subsidy payments due to non-compliance with Program Obligations.	Retained for five (5) years after the placement date of the flag.
General Contractor Performance—Construction Compliance.	Material failure to build project in accordance with approved Plans and Specifications (During Construction Period).	Retained for five (5) years after the placement date of the flag provided that noncompliance has been cured to HUD's satisfaction.
General Contractor Performance—One Year Warranty.	Failure to correct material warranty issues identified in HUD's Nine-Month and 12-Month Warranty Inspections (After Construction Period).	Retained for five (5) years after the placement date of the flag provided that noncompliance has been cured to HUD's satisfaction.

**Participants with Tier 2 flags may be approved if:**

Participants with Tier 2 flags may be approved if HUD determines that, because the participant has sufficiently improved operations and oversight to ensure that further violations will not occur or for other compelling reasons, the flag is not indicative of ongoing risk.

Questions that may be relevant to this analysis include:

- Are the underlying conditions causing the flag resolved?
- What has the participant done to mitigate the risk indicated by the flag?
- Is the flagged condition indicative of a current pattern of behavior? What has the participant done to change the underlying causes of the flagged condition or otherwise prevent the flagged condition from occurring again?
- Is the flagged condition limited in number and/or geography relative to the participant's whole portfolio? Was the flagged condition an isolated event?
- Has significant time passed since the condition was flagged?
- Was the flagged condition caused by market forces outside the participant's control?
- How does the participant's role in the flagged condition compare to his/her role in the Triggering Event and Covered Project for which they are currently seeking approval?

*Tier 3 Flags: Temporary Risk to the Department*

Tier 3 flags relate to a single and/or less serious incident of non-compliance and can be resolved and removed. Participants with

Tier 3 flags shall be approved, subject to satisfaction of the conditions listed below prior to or at the closing of the Triggering Event transaction. In the case of FHA Insurance, any conditions not met by the

issuance of the Firm Commitment shall be special conditions to the Firm Commitment.

Flag type	Reason	Duration of flag	Approval condition(s):
Failure to File Financial Statements.	Automatically Flagged when the Annual Financial Statements are overdue.	Removed when the missing Annual Financial Statements are filed or five (5) years after the placement date of the flag, whichever is sooner.	The Annual Financial Statement must be filed.
Delinquent payments three or more times in the last year.	Flagged when borrower fails to make mortgage payment by the fifteenth of the month, three or more times in a given one-year period.	Removed when there is a one-year period of time in which borrower has made all mortgage payments by the fifteenth of each respective month, or five (5) years after the placement date of the flag, whichever is sooner.	<ul style="list-style-type: none"> <li>• Delinquencies cured (no longer delinquent).</li> <li>• Explain the cause of the delinquencies.</li> <li>• Efforts and/or a plan acceptable to HUD to avoid future delinquencies must be put in place.</li> </ul>
Unacceptable Physical Condition ..	Most recent REAC score is below 60, and additional (does not need to be consecutive) REAC score(s) below 60 over the past seven years.	Removed when the most recent REAC score is above 59.	Certify that 100% of the units in the project with the low REAC score have been inspected and all physical deficiencies have been remedied.
Unsatisfactory Management Review.	Flagged when there is an Unsatisfactory Management Review.	Removed when there is a Satisfactory Management Review, or five (5) years after the placement date of the flag whichever is sooner.	Provide evidence that a satisfactory response to the management review was provided to HUD or the Contract Administrator.
Unauthorized Distributions .....	One incident of Unauthorized Distributions.	Removed when the unauthorized distribution is repaid or otherwise resolved or five (5) years after the placement date of the flag whichever is sooner.	Unauthorized distributions must be repaid.
Material Unresolved Audit Findings	Material Unresolved Audit Findings.	Removed when the finding is resolved or five (5) years after the placement date of the flag whichever is sooner.	Provide evidence that the audit finding was resolved in manner satisfactory to HUD.
Failure to Provide or Comply with Action Plan.	Failure to provide or comply with a HUD required action plan and/or certification in a timely manner.	Removed when the action plan is received and in good standing or five (5) years after the placement date of the flag whichever is sooner.	Provide evidence that the Action Plan was approved by HUD and implementation has begun.

3. *Flag Resolution and Removal of Flags.*  
 Tier 1 flags are permanent and are not removed from the APPS system, except where indicated in the Tier 1 chart above that HUD determines removal is warranted due to mitigating circumstances. Tier 2 flags will be removed from the APPS system upon the completion of the conditions and time periods listed in the Tier 2 chart above. Tier 3 flags shall be removed from the APPS system upon the resolution of the violation giving rise to the flag. Participants shall be notified in writing when flags are resolved and/or removed and may request confirmation of flag resolution and/or removal if they do not receive such notification.

Notwithstanding anything else in this Guide, for any flag, if the Branch Chief or Director of Asset Management determines in

writing that retention of the flag for the time periods listed above is inappropriate and unduly burdensome on the Controlling Participant or HUD, the Branch Chief and/or Director of Asset Management may waive this Guide's requirements with respect to duration of the flag and approve the flag's removal. In providing this determination, the Branch Chief or Director of Asset Management must consider any comments in the APPS system, including any comments indicating why the flag is warranted. If comment in the APPS system clearly describe that the flag is warranted and set out a justification for approval in forthcoming transactions despite the presence of the flag (as discussed in this Guide above), the flag may not be unduly burdensome and retention of the flag may be warranted. If, however, the Branch Chief or Director of

Asset Management determines that retention of the flag is unwarranted or otherwise inappropriate and unduly burdensome on the Controlling Participant, the Branch Chief or Director of Asset Management shall indicate the basis for such determination and direct that the flag be removed.

*H. Significant Changes to the Guide*

HUD will not make any significant changes to the Guide without first offering advance notice and the opportunity for comment for a period of not less than 30 days.

*I. Technical Assistance*

Technical Assistance can be found on the HUD Web site at: [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/housing/mfh/prevparticipation](http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/mfh/prevparticipation).

Questions can be directed to:

Office of Multifamily Housing & Assisted Housing Oversight Division ....	<i>MF_PreviousParticipation@hud.gov.</i>
Office of Residential Healthcare Facilities .....	<i>LeanThinking@hud.gov.</i> <i>www.hud.gov/healthcare.</i>
Office of Hospital Facilities .....	<i>Hospitals@hud.gov.</i> <i>1-877-HLTH-FHA.</i> <i>www.hud.gov/healthcare.</i>

**Addendum: Identification and Certification of Limited Liability Investor Entities**

The following certification is to be submitted as part of the FHA loan application from each entity which claims to be a limited liability investor.

Project Name:

FHA Project #:

I, [*name of authorized signer*], am authorized to certify on behalf of [*name of investor entity*] to each and every item stated below.

I certify that [*name of investor entity*] is:

a. Investing in [*name of owner/mortgagor entity*], which anticipates receiving [*list applicable tax credits, e.g.: Low-Income*

Housing Tax Credits pursuant to Section 42 of the Internal Revenue Code];

b. A limited liability company, an investor corporation, an investor limited partnership, an investor limited liability limited partnership or other similar entity with limited liability; and

c. An investor with limited or no control over routine property operations or HUD regulatory and/or contract compliance, unless it should take control of the ownership entity or assume the operating responsibilities in the event of the default of the operating partner or upon specific events defined in the [*name of owner/mortgagor entity*]'s [*operating agreement/partnership agreement/organizational documents*].

I further certify that should any of the facts or circumstances that support the certifications above change or the entity for which this certification is made withdraws from participation in the owner/mortgagor, I will notify HUD immediately in writing, providing full disclosure and explanation of the change(s).

Signed: \_\_\_\_\_

[*Name of authorized signer*]

[*Title*]

Date: \_\_\_\_\_

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