SECTION 3. DETERMINATIVE CRITERIA FOR REVIEW OF TPAs

The following are criteria employed by HUD to evaluate Full Review and certain Modified Review proposals:

13-10. Requirement that a Proposed Owner/Managing General Partner Obtain Previous Participation Clearance.

The proposed principal(s) must obtain previous participation clearance:

A. Proposed principal(s) must file form HUD-2530, Previous Participation Certificate; and

B. Prospective owner/managing general partner must also satisfy the Field Office that he/she has sufficient experience to operate the particular project which he/she intends to purchase. A troubled project may require an owner/managing general partner who has demonstrated the ability to successfully own and manage troubled multifamily projects.

13-11. Field Office Requirement for Management Review and Physical Inspection and a Requirement For Proposed Management Agent Previous Participation Clearance.

Management Reviews, Physical Inspections and approvals of existing or new management agents are interrelated determinations required prior to Field Office preliminary approval of a TPA.

A. Existing Management Agent

The TPA process provides the Field Office with an opportunity to influence the selection of a management agent. Field Offices should use the

flexibility provided by Handbook 4381.5 to impose necessary performance standards on a new management agent, particularly when troubled projects are involved. This requirement is directly related to ratings on management review and physical inspection reports. Management Reviews and Physical Inspections are to be conducted in a schedule required in the following sections.

B. Management Review

If the Field Office has not completed a management review of the project within one year of the date of the TPA application, it must do so prior to granting preliminary approval of a TPA, whether or not a change in management agent is proposed. The level (comprehensive or limited) and intensity of the management review is based on factors identified in this Handbook in Chapter 6, entitled Project Monitoring, and the Field Office must exercise discretion in making this determination.

If the TPA proposes to retain the existing management agent, the Field Office must review the past performance of the agent and determine whether or not the agent is performing at a satisfactory level.

C. Physical Inspection

If the Field Office has not performed a physical inspection of the project within the past year, it must do so prior to granting preliminary approval of a TPA, whether or not the mortgagee has performed an acceptable inspection.

D. A proposed new management agent must obtain previous participation clearance and must abide by other requirements:

1. Proposed management agents must file form HUD-2530, Previous Participation Certificate,

2. Proposed management agent must satisfy the Field Office that he/she has sufficient experience to enable him/her to successfully

manage the project. The type and length of experience required will vary depending upon the degree of difficulty of managing the particular project;

3. A new or replacement agent is required to abide by the instructions contained in Handbook 4381.5, Management Agents, Documents and Fees. This includes the filing of a Management Certification and an Agent Profile.

13-12. Determination by Field Office that a Project's Physical Repair/Replacement Needs Will Be Met.

In order to approve the proposed transfer, the Director of Housing Management must determine that the project will be restored to sound physical condition within 24 months from the date of transfer. Additionally, he/she must be satisfied that requisite energy-related alterations will be completed within an acceptable time frame. (See Handbook 4350.1, Chapter 12, for a discussion of energy-related items.)

A. Extension of Time Requirements

Under certain well documented circumstances, the Field Office Manager may extend this period for up to an additional 12 months. The decision to allow additional time must be documented in the project file. The time period cannot be extended, if the sources and uses statement shows one of the following:

- o remuneration to the seller; or
- o fees to participants having priority over the needs of the project.

B. Determination of Project Physical Condition

The physical condition of the project may be determined in one of two ways:

1. If the project is ranked as a troubled or potentially troubled project, the Field Office must perform its own inspection if such an inspection had not been performed within the past year; or

2. The transfer applicant may submit to HUD at the time of application a physical inspection report and cost analysis of needed repairs for the project, prepared by an architect or engineer who is professionally designated and licensed in the jurisdiction where the project is located.

The inspector will provide a certification as to his/her qualifications and as to the accuracy of the report and cost estimates based on his/her professional opinion.

The Chief of Loan Management will decide which approach is appropriate. In certain situations, the Field Office may also elect to do an inspection, the results of which will suggest the need for a follow-up inspection by an expert in a particular functional area, such as a structural or HVAC engineer. This follow-up inspection will clearly be the responsibility of the applicant.

C. Requirements for Acceptable Physical Inspection.

The following are minimum requirements for an acceptable physical inspection:

1. The inspection report must be in sufficient detail to list all required repairs and provide line item cost estimates for repairs;

2. The report should mandate all those repairs that are necessary to ensure that the project is structurally sound and that dwelling units and living conditions are decent, safe and sanitary. The repair listing must be complete and deal with 100 percent of the units;

3. The report should specify that the project is energy efficient, or that repairs will make it so;

4. The report must describe how the inspection was performed and any assumptions that were made by the engineer. For example, if all

the units were not inspected, what units were inspected and how were those units selected? How did the engineer go about making the final repair list?; and

5. The engineers and architects should also provide comments on the remaining useful life of major equipment and fixtures at the project (this analysis will be important in judging the appropriateness of Reserve for Replacement funding).

The goal of a quality physical inspection and subsequent repair/replacement recommendations is not to return the project to the original condition when initially insured, but rather to ensure the long-term viability of the project.

The Field Office will have the responsibility for reviewing the applicant's inspection report and affirmatively judging its adequacy. This will require a Field Office inspector verifying the applicant's report with an on-site visit.

D. Availability of Physical Repair/Replacement Funds

Because the financial viability of the project is a critical determination in approving a TPA, the following criteria for use and availability of repair/replacement funds must be met:

1. The Field Office must be satisfied that adequate funds will be available to complete needed physical improvements/repairs. The purchaser should accomplish the repairs pursuant to a repair schedule (e.g., a MIO plan) approved by the Field Office. The repair schedule should be specific as to objectives and timing so that the progress of the repairs can be judged by the Field Office.

   The Field Office may require the purchaser to obtain a letter of credit, a bond, or place in an escrow account acceptable to the Field Office, the funds needed to complete the proposed improvements/repairs.

2. If a project is transferred within the first twelve months from the date of final

endorsement and if there are latent construction defects, HUD's first remedy for correction of these defects is to use the bond that was posted for this purpose during the construction period. Only if the bond cannot be used or will not cover all of the latent defects should correction of these defects be addressed as part of the transfer proposal.

13-13. Determination by Field Office that a Project's

Operating Financial Needs Will Be Met.

A. HUD-Insured Projects

An application for transfer of a HUD-insured project will be accepted only if the project mortgage is current or the Field Office determines it will be brought fully current as a result of the TPA at preliminary approval.

B. HUD-Held Projects

In order to approve a proposed transfer of a HUD-held project, the Field Office must establish that either the mortgage will be brought current at the time of transfer or that an acceptable workout will be executed. Any workout, in conjunction with a transfer, must be executed upon preliminary approval of the transfer. Workouts that exist prior to the TPA approval must be reviewed and modified as necessary. For example, if repairs are required as part of the TPA, the repair schedule will be included in a modified or new workout.

C. All Projects

For all projects, Field Offices must assess the financial situation and make certain determinations and require certain actions be taken, as follows:

1. All accounts payable will be cleared at the time of the transfer or shortly thereafter. If deemed necessary by the Field Office, a satisfactory escrow or letter of credit may be required to ensure that this requirement is met;

2. Make a determination that the Reserve for Replacement Account is adequately funded, and will continue to be adequately funded in the foreseeable future. To determine the level of funding for the Reserve for Replacement Account, the Field Office must consider the project's present and anticipated needs. It should review the remaining useful life of major equipment and structural components and make a determination that the Reserve for

Replacement is funded at a level to meet the most immediate project needs;

3. The Field Office may require lump sum contributions as part of the TPA or a plan to increase deposits to the Reserve until it is funded to an appropriate level. For both full and modified TPAs, if escrowed funds remain after completion of the required repair program, these remaining monies should be used to fund the Reserve for Replacement Account at an appropriate level. Although there are no hard and fast rules, the Field Office should follow common sense rules of thumb. For example, a 15 year old project, which has not replaced stoves, refrigerators, air conditioning, roofs, kitchen cabinets, common area and apartment amenities, such as carpeting, etc., should have a Reserve for Replacement Account balance of $1,200 to $1,500 a unit. The above yardstick is meant for reference only, and naturally jurisdictions may determine what funding level of Replacement Reserves per unit is considered appropriate and adequate for projects within their localities based on local environment, custom and practice.

4. The Field Office should review the other mortgagee controlled accounts (real estate and property insurance escrow), to make sure present balances together with monthly deposits will be sufficient to pay near term billings. Frequently, TPAs lead to reassessments that result in property tax increases the property cannot easily manage. The Field Office may decide to require an

increased deposit to these escrows, if it has reason to believe the property will be facing a substantial increase in its property tax or property insurance bills; and

5. Field Offices should review the source and use statement provided by the applicant as a possible source of additional funds, if there is a cash shortfall in meeting the project's financial needs.

13-14. Field Office Determination Concerning HUD Legislative, Regulatory and Administrative Requirements.

The transfer of physical assets proposal must comply with HUD regulations, handbooks, administrative and legal requirements as of the date of this Notice. Relevant HUD documents include but are not limited to the following:

HUD HANDBOOKS	TITLE/CHAPTER
HUD Handbook 4350.1 REV-1	Chapter 4, Section 11 Chapter 6 Chapter 12
HUD Handbook 4065.1	Previous Participation
HUD Handbook 4355.1 REV-1	Flexible Subsidy
HUD Handbook 4370.1 REV-2	Reviewing Annual and Monthly Financial Reports
HUD Handbook 4370.2 REV-1	Financial Operations and Accounting Procedures for Insured Multifamily Projects
HUD Handbook 4370.4 REV-1	Basic Accounting Desk Reference for Loan Servicers
HUD Handbook IG 2000.4	Consolidated Audit Guide for Audits of HUD Programs
HUD Handbook 4381.5 REV-1	Management Documents, Agents and Fees

HUD REGULATIONS/SECTION	TITLE/CHAPTER
24 CFR 265	Transfer from Nonprofit to Profit-Motivated Ownership for Multifamily Housing Projects
24 CFR 207.1(h)	Transfer Fee

MULTIFAMILY NOTICES	TITLE/CHAPTER
Notice 84-34	Revised Policy for Projects with HUD-Held Mortgages
Notice 89-1	Reinstating Defaulted Mortgages
Notice 90-17	Combining Low Income Housing Tax Credits (LIHTC) with HUD Programs
Notice 90-18	New Restrictions on Funding Actions
Notice 91-22	Comprehensive Multifamily Servicing Program
Notice 84-37	Appendix G: Memorandum from Charles J. Bartlett, Legal Review

of Transfer of Physical Assets
Proposals

13-15. Special Circumstance Determination: Secondary Financing

Any portion of the purchase price which is not paid in cash at the time of purchase is understood to be secondary financing. Secondary financing includes all deferred financing: financing secured by the project, financing secured by collateral other than the project, or unsecured financing.

Field Offices must make certain specific determinations when secondary financing is an element. The legal and administrative requirements for approval of a TPA with secondary financing include the following:

A. HUD policy permits the use of secondary financing in connection with transfers of projects only in those situations in which the Field Office determines that the proposal does not jeopardize HUD's security, conflict with HUD's legal or programmatic interests, or unduly burden the project with financial debt.

B. If HUD-insured secondary financing is proposed as part of the TPA, it must meet the underwriting criteria of the applicable section of the Act (241 supplemental loan, operating loss loan, etc.).

C. The legal requirements controlling the use of secondary financing are set forth in the opinion of the Assistant General Counsel for Multifamily Mortgage Insurance in Appendix G of this Chapter.

Area Counsel must review all secondary financing in connection with a TPA and determine that it meets the requirements of Appendix G prior to the Field Office granting preliminary TPA approval.

D. Field Office will approve the use of secondary financing in a TPA only when the following conditions are met:

1. When the first mortgagee approves in writing any secondary financing secured by a lien against the project. Field Offices must not approve any transfer that includes a lien against the project without this written

mortgagee approval;

2. When approval of the secondary financing will not increase HUD's exposure to financial risk or loss; and

3. When approval of the proposal would not violate the Department's obligation to provide housing at the least cost to the Federal government.

E. Where the consent of the first mortgagee to allow secondary financing is obtained, the original signed document must be transmitted immediately to the Office of Multifamily Housing Management at HUD Headquarters for inclusion in the project's safe instruments file.

13-16. Special Circumstance Determination: Condominium/Cooperative Conversions

Every proposal involving conversion to the cooperative form of ownership must include either the express consent of the mortgagee to the conversion or an indemnity agreement acceptable to HUD. The HUD Office of General Counsel has developed a master Indemnification Agreement, Guaranty Agreement and Letter of Credit for use in conversions to cooperative ownership without mortgagee consent. In the case of a transfer transaction involving conversion, Field Offices are referred to OGC's Multifamily Mortgage Division "at Headquarters" for relevant forms and consultation. The Housing Management Division retains responsibility for the programmatic and policy review of proposed conversions to condominiums and

cooperatives but may not grant preliminary approval without Field Counsel's legal opinion as to the legality of the proposed conversion. When conversion to condominium or cooperative ownership is an element of the transfer, Field Counsel must review the proposed transaction.