



ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT  
WASHINGTON, DC 20410-8000

**DATE: October 24, 2018**

**MORTGAGEE LETTER 2018-09**

TO: All Multifamily Hub Directors  
All Program Center Directors  
All Project Managers

SUBJECT: Revised Concentration of Principal Risk Criteria

**I. PURPOSE AND BACKGROUND**

This Mortgagee Letter updates past guidance related to identifying and mitigating risks posed to the FHA Insurance fund associated with increasing levels of insured loan balances of entities and their identified Key Principals that intend to submit applications for concentrated risk review.

**A. Previously Issued Risk Mitigation Guidance**

Beginning in 2010, HUD-FHA experienced unprecedented demand for mortgage insurance, leading FHA to examine ways to evaluate and manage counterparty risk and to identify and mitigate risks concentrated in the portfolios of large borrowers requesting new mortgage insurance.

The Risk Mitigation Mortgagee Letter (HN 2010-11, ML 2010-21) required FHA to give greater scrutiny to business entities with aggregate insured balances greater than \$250 million. The specific criteria for review of these large borrowers were described in Mortgagee Letter (ML) 2013-09, and a related Housing Notice entitled "Concentration of Principal Risk: Principals with Insured Assets Greater than \$250 Million". These Notices/Mortgagee Letters were intended to manage risk from FHA borrower entities, including related principals involved as decision-makers in multifamily housing insured by FHA.

A Key Principal is, or Key Principals are, those member(s) of business entities which, if they suffered material negative financial or legal problems, would pose a risk to HUD. The Concentrated Risk ML requires prior credit approval for large borrowers, focusing on the overall performance of the principal's portfolio, past and present business practices, and ability to remain successful in view of possible negative market trends or events. The credit analysis is prepared by a lead lender and is reviewed by the Technical Support Division of the Office of Multifamily Production at HUD Headquarters. A typical decision lays out parameters that must be met by the

principal as a prerequisite to filing new applications for mortgage credit or as a provision of future Firm Commitments.

## **B. Borrower Concentrated Risk**

Over time, the levels of aggregate loan balances for some principals have increased, with balances well exceeding \$500 million. These portfolios can also involve varied degrees of borrower risk generated by factors such as:

- An imbalance of new construction in the borrower portfolio;
- Concentrations of insured loans in similar geographic areas;
- Risk associated with excess and/or unwarranted litigation, including asset management and financial deficiencies; or
- An aggregate loan balance that presents a single point of failure risk to the FHA insurance fund if a key principal (or principals) of the business entity would suffer an event that would materially, negatively affect their portfolio.

The number of concentrated risk review requests have continued to increase since 2013, and FHA borrowers have steadily increased the size of their insured portfolios from their initial and any subsequent approval level. At least 14 Key Principals self-reported concentrations exceeding \$250 million in FY 2017 with steadily increasing loan balances in some cases exceeding \$1 billion.

These factors have caused HUD to revisit the concentrated risk review process and the criteria used to conduct these reviews.

## **II. UPDATED SCOPE AND PROCESS FOR PRIOR CREDIT REVIEW AND APPROVAL**

The scope and process of prior credit review and approval as described in Mortgagee Letter 2013-09 remain in full effect.

The following is an update to the required level of review for Concentrated Risk applications based upon the Principal's aggregate loan balances, and the loan balance limits that FHA should accept on a per-borrower basis without additional limits of approval, and the loan balance limits that necessitate approvals of Transfers of Physical Asset to comply with the revised requirements.

### **A. Applicability – Review Threshold and Term of Approval**

This Mortgagee Letter applies to all applications for FHA multifamily mortgage insurance programs, except for refinancing pursuant to Section 223(a)(7) of the National Housing Act and programs administered by the Office of Healthcare. This Mortgagee Letter also applies to all applications for Transfer of Physical Assets in cases where the ownership interest of the transferee meets the definition of an Active

Principal in accordance with Section 8.3 of the Multifamily Accelerated Processing (MAP) Guide (4430.G).

The risk review threshold is increased from \$250 million to \$500 million, and the term of the approval is increased from one to two years unless circumstances direct a lesser term. Examples of such circumstances include loan portfolios with an imbalance of pending new construction projects either in process or in rent up, poor REAC scores for a significant percentage of insured properties, mortgage credit issues deemed to create risk, such as excessive litigation and instances of inadequate disclosure in either underwriting or in asset management reviews, material decline in principal credit history and declines in other key financial measures such as cash flow, net worth, liquidity, debt maturities, and operational stability.

## **B. Program Areas Responsible for Risk Reviews based on Levels of Exposure**

The program areas required to review risk applications and the authority to approve decision memos based upon the requested unpaid loan balance is as follows:

- i. All reviews below \$800 million are to be conducted by the Technical Support Division and may be signed by Director of Technical Support, as is the current practice;
- ii. Reviews exceeding \$800 million but less than \$1.2 billion are to be jointly reviewed by the Technical Support Division and the Multifamily Asset Counterparty Oversight Division (MACOD), with the decision and approval amount jointly approved by the Deputy Assistant Secretary for Multifamily Programs and the Deputy Assistant Secretary for the Office of Risk Management and Regulatory Affairs. In the event of a disagreement on approval, the borrower request and review will be elevated to the FHA Commissioner or his or her Designee for decision;
- iii. Reviews exceeding \$1.2 billion are to be jointly reviewed by the Technical Support Division, MACOD, and ORM with decision and approval authority reserved to the FHA Commissioner or its Designee; and
- iv. Reviews exceeding \$2.4 billion will be subject to additional levels of review and approval.

## **C. Maximum Insured Balance Limit**

A maximum insured balance limit above \$1.2 billion for any borrower will be determined on a case by case basis with criteria that include metrics such as the amount of loan balance of existing, FHA insured projects as a percentage of a Borrower's total portfolio, ratio of level of liquid assets to overall net worth, equity, geographic concentration of insured assets, ranked performance metrics, and other metrics as may be determined in the context of specific credit approval requests.

## **D. Reporting**

Centralized reporting will be developed by Office of Risk collaboratively with Multifamily Production on key metrics to streamline the concentrated risk review and will include improved reporting in centralized systems. This information will be made available to key members of Multifamily Production, Asset Management, and Risk to inform decision-makers on the historical and current performance of business entities.

### **III. IMPLEMENTATION**

This Mortgagee Letter is effective immediately.

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0029. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

If there are any questions, and/or concerns regarding this Mortgagee Letter please contact Thomas Bernaciak, Deputy Director, Office of Multifamily Production at (202) 402-3242 in HUD Headquarters, Office of Multifamily Housing Development. Persons with hearing or speech impairments may access this number via TDD/TTY by calling 1-877-TDD-2HUD (1-877-833-2483).

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