

Housing Alert

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HUD's Expected Proposed Rule Would Expand the Reach of the 2530/Previous Participation Certification Process

by Mary Grace Folwell

As 2006 comes to a close, HUD is expected to publish a proposed rule that would significantly alter the previous participation certification process for participants in multifamily housing projects. We have reviewed a draft copy of this rule and have concerns about vagueness surrounding several of its proposed standards and the provision of adequate notice and due process rights when a project is flagged.

We encourage all parties concerned about the changes to the 2530 previous participation standards to consider submitting comments to HUD on the proposed rule during the 60 day comment period that will follow the proposed rule's publication in the Federal Register. Ballard Spahr stands ready to assist in drafting these comments. Comments from a wide range of stakeholders can help guide HUD in the crafting of a final rule that will be fair to participants as well as meet HUD's objectives that it only does business with participants that "will honor their legal, financial and contractual obligations."

HUD's Office of Multifamily Housing uses the previous participation certification process to review the previous performance of parties that apply to do new business with HUD to ensure that HUD does business with participants that "will honor their legal, financial and contractual obligations." The proposed rule calls form HUD-2530 a "previous participation certification" ("PPC"). Major substantive changes in the proposed rule include (1) expanding the definition of "participant," (2) requiring housing authorities to submit a 2530/PPC, (3) creating a new, vaguely defined adverse indicator of risk, (4) introducing vague and broad grounds for flagging a participant, (5) creating a new, bright line rule for denying participation, (6) introducing an informal, pre-decisional due-process proceeding, and (7) eliminating the right of appeal of an adverse determination.

"Principal" Definition Renamed and Expanded

Under the proposed rule, entities required to file a PPC are called "participants" rather than "principals," and the proposed

rule creates three classes of participants—operational, supportive, and investment. Operational participants are essentially the equivalent of principals in the current rule. Operational participants have general and routine control over a property and include, but are not limited to, owners, operators, CEOs, CFOs, board presidents and board chairs. Supportive participants are those that support an owner in delivering services or operating the property. Investment participants are passive investors in HUD programs that have no operational or policy control or influence. Investor participants are not required to file a PPC; however, operational participants are responsible for filing a PPC on behalf of an investment participant. Affiliates of participants must also file PPCs.

For corporations, LLCs, partnerships, LPs and other similar corporate forms, the proposed rule changes the percentage interest in the participant of any stockholder, member, or partner that triggers the PPC filing requirement from 10% to 25%. The proposed rule also clarifies that stockholders are exempt from 2530 filing requirements if such stockholders are large, publicly traded corporations where real estate investment is not the primary corporate endeavor. The proposed rule also adds the requirement that all organizations must disclose at least one responsible natural person in order to be cleared for participation in HUD's multifamily housing programs.

In addition to expanding who must file a PPC, the proposed rule expands the PPC requirement to several new programs, such as:

- Housing Finance Agency risk sharing programs under section 542(c) of the Housing and Community Development Act of 1992
- Hospital mortgage insurance under section 242 of the National Housing Act
- Sales of projects owned by HUD only where the project continues to receive HUD assistance, is subject to an income restriction, HUD use agreement, or other continuing relationship with HUD

- Applications to transfer, assign, or assume a subsidy contract
- Projects covered by a housing assistance payments (HAP) contract
- Projects covered by a project rental assistance contract (PRAC)
- Section 811 projects

Housing Authorities Must Now Comply

The existing rule exempts housing authorities from the 2530 filing requirement. The proposed rule would require housing authorities to submit a PPC “when [the] PHA applies to purchase, operate, or receive benefits from a HUD-related multifamily housing project as an owner, agent, or consultant.”

New Standards for Disapproval

The proposed rule introduces several new standards for disapproval while maintaining all existing standards. The new standards that would justify disapproval of a participant include:

- A physical condition assessment or series of assessments below HUD’s standards
- Mortgage delinquency or default that continues for more than a single month in any 12-month period (also known as a rolling delinquency or rolling default)
- A less-than-acceptable review of management operations or a series of assessments below acceptable standards
- Any failure or series of failures to file a financial report or to provide requested information when due
- False certifications or claims made on any HUD document

Additionally, the rule proposes a bright line standard by which HUD will disapprove participation in new business for any operational participant for one year that has had an insured mortgage assigned in exchange for multifamily mortgage or hospital claim against the insurance fund or funds and where such activities occurred within 12 months prior to the application for new business.

Vague Standards Reduce Transparency

Several changes in the proposed rule introduce vague standards, sharply diminishing the transparency of the 2530/PPC review process. The proposed rule introduces a new negative indicator of risk called the “mark.” A participant may receive a mark regardless of the presence of a flag for a specific incident of non-compliance. A mark requires HUD headquarters review all applications for new business for that participant. However,

there are no due process rights for participants who receive a mark. It is not clear what actions on the part of the participant justify a mark, how the review process by the Review Committee is conducted for participants with a mark, and whether a participant will receive any notice or opportunity to address a mark.

The proposed rule also introduces very broad and vague standards for the flagging of a participant. In the proposed rule, authorized HUD field office staff and managers may enter flags for “any noncompliance with any regulation, contract . . . or legally binding agreement or failure to perform to any generally applicable standard.” HUD should clarify how this standard will be applied and more clearly define an event of noncompliance.

Change in Due Process Procedure

The proposed rule creates a new informal hearing process before the Review Committee makes a determination and eliminates the post-decisional right of appeal. Under the proposed rule, the informal hearing may be conducted in person, by phone or upon written submissions, and the participant is entitled to present testimony and documentary evidence, and to be represented by counsel. However, after this informal hearing, the Review Committee’s determination will be considered a final agency decision, which means a participant may have the right to appeal the Review Committee’s decision in federal court.

HUD should add a requirement that participants are provided notice as soon as a flag or mark is placed on a file so that the participant may begin immediately to address the noncompliance.

The transparency and predictability of the 2530 previous participation review process is critical for both HUD and multifamily program participants. HUD needs private actors to continue to invest in affordable housing projects. Private actors need to understand HUD’s requirements in order to efficiently and effectively participate in HUD multifamily programs. We welcome HUD’s efforts to clarify the applicability and scope of the 2530/PPC review, and look forward to working with clients and HUD to produce a rule that will minimize risk to HUD without unfairly burdening participants.

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