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## HUD issues final 2530 regulation

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Very recently, HUD published on its website the final 2530 rule. The 2530 process governs HUD's clearance of applicants in certain HUD programs by reviewing the applicants' previous participation in government programs. The 2530 regulations were first issued in 1980 and for some time now have been considered significantly outdated and not reflective of current day affordable housing deal structures and transaction practices. The proposed rule was issued in August of 2015 and was meant to comprehensively overhaul the 2530 regulations. HUD received 33 public comments to the proposed rule. In May, HUD supplemented its proposed rule to provide that in conjunction with the final rule a "processing guide" containing administrative guidance to supplement the regulations would be issued. The majority of the final rule contains HUD's responses to the 33 comments. Whether the new regulation and the processing guide will facilitate 2530 clearance remains to be seen.

A summary of the significant changes made in the final rule are listed below:

1. References the processing guide as a supplement to the regs and requires that changes to the guide be done through notice and comment.
2. Establishes a separate definition of "risk".
3. Clarifies that a "covered project" include projects subject to continuing HUD requirements administered by HUD's Office of Housing.
4. Includes construction managers as "controlling participations" in 242 projects.
5. Includes individual or entities with the ability to "direct the day-to-day operations" as controlling participants.
6. Provides that board members of a nonprofit that do not otherwise control the day-to-day operations of the nonprofit are NOT controlling participants.
7. Clarifies that a change in a controlling participation is a triggering event if HUD consent is required for such a change.
8. Provides that reconsideration decisions shall not be rendered by the same individual who rendered the initial review.

HUD now defines risk in terms of requiring HUD to determine whether an entity's participation in a covered project would constitute an unacceptable risk by determining whether the controlling participant could be expected to participate in the project in a manner consistent with furthering HUD's purposes. HUD must look at (1) compliance with applicable statutes, regulations and program requirements, and (2) the previous financial and operating performance in covered projects that may indicate a financial or operating risk. HUD *may* consider participation and performance in any federal, state or local government.

Previously, the 2530 process used the term "principal" which has been replaced with "controlling participant" and includes owners, borrowers, management agents, 242 operators, 242 master tenants, general contractors, and 242 construction managers. Furthermore, HUD remains interested in piercing through entities to get to individuals and includes as a controlling participant any individual or entity determined by HUD to control the financial or operational decisions of an owner, borrower, management agent, etc. including:

1. those with ability to direct the day to day operations of the project or the entity;
2. a 25% or more owner of an entity;
3. entities or individuals with the ability to direct an entity to enter into agreements relating to triggering event;
4. members of hospital board and executive management that HUD determines have control over the finances or operation of a project.

Excluded are (1) passive investors and investor entities in tax credit properties including but not limited to section 42 including syndicators, director investors or investors; (2) individuals or entities that do not exercise financial or operational control over a covered project, specified capacity or controlling participant; (3) board members of a nonprofit corporations who are not officers or part of the executive management team (with HUD confirmation); (4) mortgagees, and (5) PHAs.

Of great interest is the processing guide which gives more direction on the practicum of submitting 2530's under the new rules. Applicants need to provide HUD both a full organizational chart showing all of the participants (there are very detailed instructions on what entities and individuals need to be shown) and separately a list of what the applicant determines are controlling participants that are subject to 2530 disclosures. The guide confirms the 2530 form is still in use and sets forth that HUD prefers electronic filings though paper will be accepted.

The guide also provides more detail on the definition of a controlling participant, including: managers and managing members of a limited liability company; any type of general partner in a limited partnership; partners in a general partnership; the executive director of a nonprofit corporation; controlling stockholders of a corporation; trustees of a trust; the CEO and all company officers exercising day to day control of a REIT; and part 50 guarantors. Also, HUD clarifies here that wholly owned entities, shell entities, tax credit investors, passive investors and “minor” officers in a corporation are excluded as are members of boards of directors of nonprofits, less than 25% owners, nursing home administrators and directors of assisted living facilities. For publicly held companies the CEO, the controlling shareholders and any other individuals identified as having day to day control including any relevant project manager must file but the company shall otherwise be treated as an individual without need for other individual shareholders to file.

Lastly, the guide also treats the ever important subject of flags. HUD states that “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.” HUD provides direction to the field on the placement of flags including directing the field to not place any flags on controlling participants in connections with violations that occur prior to their involvement or relating to ongoing violations for entities who become involved with HUD consent to mitigation or remedy the ongoing violation unless new flags come up after the entity has been involved. There are three tiers of flags, Tier 1 being the most serious and Tier 3 the least. Tier 1 and 2 flags must be reviewed by branch chief prior to placement. Tier 1 flags indicated elevated risk and are permanent. Participants may still participate if the flag has been appropriately mitigated. Tier 1 flags include mortgage assignment, partial or full FHA claim, suspension debarment, conviction for fraud or embezzlement, to name a few. Tier 2 flags are 5 year flags and represent repeated offenses (3 + instances in a seven-year period) including failure to file AFS, financial default, REAC failure, unauthorized distribution. Tier 3 flags related to single and/or less serious incidents of noncompliance and these can be removed when resolved. They include failure to file AFS, failed REAC, unsatisfactory MOR, and material unresolved audit financing. The guide provides specific actions to be taken by the applicant to resolve all types of flags. For a single instance of a failed REAC, the applicant must certify that 100 percent of the units in the project have been inspected and all physical deficiencies have been remedied.

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