III, 604: Experience and Qualifications (11/06/03)

Investigation of the Borrower's, the Key Principals', and Principals' previous experience for transactions underwritten at all four Tiers must indicate a history of ethical and quality business practices and a high degree of responsibility, particularly in the resolution of past problems, if any.

The Lender must establish that the Borrower, and its Key Principals and Principals have a suitable business organization and the requisite business experience to operate and manage (directly or by contract) a multifamily housing Property throughout the term of the Mortgage.

III, 604.01: Required Releases (11/06/03)

The Lender must obtain appropriate releases from the Borrower and each Key Principal and Principal before requesting any credit reports, mortgage payment records, or financial information and must make every effort to ensure the confidentiality of such information.

III, 604.02: Certified Multifamily Ownership and Loan History Statement (11/06/03)

Each Borrower with prior experience and each Key Principal and Principal must submit a Certified Multifamily Ownership and Loan History Statement (Exhibit III-13). The Borrower's Statement must be certified by the managing general partner or the chief operating officer, as applicable, and all Statements must be certified as true, correct, and complete. The Statements from the Borrower, the Key Principals, and the Principals must be dated not more than 90 days prior to the date the Lender requests a Commitment from Fannie Mae (or 90 days from the date of the closing for an assumption). These Statements must be updated with either a new Statement or a Statement of no adverse change, if the 90-day period is exceeded. Separate Statements must be obtained from each individual and entity.

No Borrower, Key Principal, or Principal may be insolvent or involved in a bankruptcy (or similar) proceeding at the time the Mortgage Loan is made. If the Borrower or any Key Principal or Principal discloses any defaults, foreclosures, bankruptcies, or deeds-in-lieu of foreclosure in the previous ten years, the cause and resolution of such occurrences must be explained (in writing) and determined to be acceptable by the Lender.

For any defaults, foreclosures, bankruptcies, deeds-in-lieu of foreclosure, or material delinquencies, an acceptable explanation must clearly indicate that the circumstances causing the problem were unforeseeable and not directly caused by the Borrower, the Key Principal, or Principal, that the Borrower, Key Principal, or Principal took appropriate and significant actions to avoid and cure the problem, and that the Borrower, Key Principal, or Principal exhibited a high degree of integrity and responsiveness in reaching an equitable resolution in a timely manner.

In the case of a past foreclosure, a bankruptcy, significant litigation, or a judgment, the Lender must be particularly diligent in evaluating both the capacity and the willingness of the Borrower and its Key Principals and Principals to support the Property.

III, 604.03: Borrower's, Key Principal's, and Principal's Experience with Fannie Mae (11/06/03)

Fannie Mae's experience with a Borrower, Key Principal, or Principal may result in Fannie Mae's conclusion that such a Borrower, Key Principal, or Principal lacks the necessary quality experience, qualifications, or credit for additional loans or assumptions of existing loans. Therefore, for both initial applications and assumptions, the Lender is required to check Fannie Mae's experience with the Borrower and each Key Principal and Principal of the Borrower.

To initiate the experience check, the Lender must execute the web-based Multifamily Loan Applicant Experience Check. The Multifamily Applicant Experience Check application is located on the eFanniemae.com website under the Technology Tools & Applications submenu. The process involves sending an electronic request that contains the employee tax identification number ("TIN") for Borrower, Key Principal and Principal, entities and the social security number ("SSN") for individual Borrowers, Key Principals, and individual Principals. The system does not provide for, and will not accept, names of Borrowers, Key Principals, and Principals. The Lender is solely responsible for ensuring that the TINs and SSNs provided are the TINs and SSNs for the required entities and individuals.

From a timing perspective, the Lender should make this request as soon as an application or assumption request is received and the Lender has the TIN and SSN(s) for the applicant and its Key Principals and Principals. Given the possibility of a "No" response for a Borrower, Key Principal, or Principal (see below), it would be preferable to have this information prior to incurring costs related to the general due diligence process. If the Key Principals of the Borrower have not been identified at this stage in the loan application process, the Lender must execute another applicant experience check for all Key Principals of the Borrower as soon as they are identified.

The Multifamily Applicant Experience Check application will provide an electronic response instantaneously. A "Yes" response means that the Lender may proceed with the loan application or assumption request. A "Yes" response does not mean that the Borrower, Key Principal, or Principal is approved; the Lender is still required to complete all of the mortgage credit due diligence required elsewhere in this Chapter. A "No" response means the Lender may not proceed with an application or assumption involving a Fannie Mae multifamily loan involving the Borrower, Key Principal, or Principal for which a "No" response was given. (The Lender may not proceed with a loan application by omitting as an identified Key Principal any Key Principal for which a "No" response was given.)

The Lender must repeat the request if over 90 days will pass between the request and Commitment in the case of an application, or if fewer than 90 days will pass between the request and the closing in the case of an assumption.

The Lender is advised that a "No" response indicates only that the prospective Borrower, Key Principal, or Principal has unacceptable experience with Fannie Mae. The "No" response must not be used by the Lender as the sole reason for rejection or denial of credit in the case of any transactions not involving Fannie Mae. Any Lender that improperly uses any information obtained or compiled from the response(s), including using this information as the sole grounds for rejection of the prospective Borrower, Key Principal, or Principal in a transaction not involving Fannie Mae, will be deemed to have agreed to indemnify Fannie Mae against any and all losses and costs, including attorneys' fees, which may be incurred by Fannie Mae as a result of such improper use.

The Lender is responsible for establishing procedures to ensure that the responses obtained for all Borrowers, Key Principals, and Principals remain confidential.

The Lender will not be provided any information as to why a particular Borrower, Key Principal, or Principal received a "No" response. Under the Multifamily Applicant Experience Check process, the Lender should inform the rejected Borrower/Key Principal or Principal to direct any questions about the rejection to the Washington, DC Office (Attention: Multifamily Chief Underwriter), who in turn will advise the rejected Borrower/Key Principal or Principal to contact the appropriate Regional Vice President for Multifamily Activities/Public Finance. The rejected Borrower/Key Principal or

Principal also will be able to meet with Fannie Mae to discuss the rejection. As a result, the rejected Borrower/Key Principal or Principal will have access to the reasons for Fannie Mae's action, which should minimize the need for Lender inquires to Fannie Mae about the Borrower/Key Principal's or Principal's status.

The Lender must print dated copies of their experience check inquiries and responses for each Mortgage and maintain such copies in the Lender's files.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 6: Mortgage Credit Reviews (11/06/03)/III, 604: Experience and Qualifications (11/06/03)/III, 604.04: Credit Report (11/06/03)

III, 604.04: Credit Report (11/06/03)

Credit reports are required for the Borrower and its Key Principals and Principals. All credit reports must present the information in a readable format. If the credit report contains coded information, a translation key must be provided. The credit reports also must:

1. be from an independent consumer reporting agency and must provide the full name, address, and telephone number of the consumer reporting agency, as well as the name(s) of the national repositories that provided information for the report;

2. be dated not more than 90 days prior to the date the Lender requests a Commitment from Fannie Mae (or 90 days from the date of the closing for an assumption);

3. for Key Principal(s) and Principals of the Borrower — provide a five-year credit history;

4. for the Borrowing entity — if the Property is being refinanced or the Borrower has owned any other property, provide a five-year credit history;

5. show the Borrower's, Key Principal's, or Principal's, as applicable, credit standing among a number of creditors; and

6. include a search of the public records which must disclose whether any judgments, foreclosures, tax liens, or bankruptcies were discovered.

For each transaction, the Lender must ensure and must document in the Mortgage file that the appropriate public records were searched (e.g., at a minimum, the search must include the jurisdiction(s) in which the Property is located, the jurisdiction in which the Borrower and any Principal which is an entity is organized, and the jurisdiction in which each Key Principal's and any individual Principal's primary residence is located).

The Lender should not proceed with any transaction unless the Borrower and its Key Principals and Principals have demonstrated a five-year history of timely repayment of all debt, or all exceptions are fully reviewed and explained to the satisfaction of the Lender. A written explanation is not required for isolated short-term delinquencies on items such as personal accounts (e.g., personal revolving accounts) provided such delinquencies were promptly cured and are not recurring.

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III, 604.05: Bank References; Mortgage Payment Histories (11/06/03)

The Lender must contact all bank references provided by the Borrower and its Key Principals as well as attempt independently to locate professionals familiar with the Borrower and its Key Principals. The Lender must also sample mortgage payment histories for any non-single-asset Borrower and all Key Principals. The references and mortgage payment histories should consistently attest to the capability of the Borrower and all Key Principals to own and manage multifamily housing and should characterize each Key Principal's business conduct as ethical and professional.

If the Property is being refinanced, the Lender must obtain a certified two-year record of the Borrower's mortgage payment history from the existing note holder indicating any recasting of the Mortgage, problems with timely payment, or other problems.

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III, 604.06: Property Inspections (11/06/03)

If, based on the review of the schedule of real estate owned (see Section 605.01(a) of this Part), the Borrower or its Key Principals own or operate properties that are located close enough to the Property so that they could reasonably be inspected during the Lender's loan underwriting, the Lender must inspect those properties. If properties owned or operated by the Borrower or its Key Principals cannot reasonably be inspected during the loan underwriting, the Lender should question an independent third party familiar with the properties, if possible.

The Lender's property inspections should indicate an ownership philosophy of maintaining a high quality asset as evidenced by good physical condition and professional management. If the inspections indicate a pattern of significant deferred maintenance, poorly trained on-site personnel, or other indications of undesirable management practices, the Borrower or Key Principal is not eligible under the DUS product line. However, if the occurrence of such management practices appears to be an isolated incident in the Borrower's or Key Principal's portfolio, the Lender may request a written explanation of the problems noted. The Lender may proceed with the transaction only if the Borrower's or Key Principal's explanation demonstrates that the problems result from circumstances beyond the Borrower's or Key Principal's control (e.g., the property was recently acquired). The Lender must be confident that the Property securing the Mortgage will be adequately maintained and managed.

III, 605: Review of Financial Statements and Tax Returns (11/06/03)

The evaluation of financial statements and tax returns will vary in scope and detail depending on the Tier used and the structure and financial condition of the Borrower and its Key Principals. Special reduced requirements for Tier 3 and Tier 4 transactions are set forth in Section 605.04 of this Part. The Lender's review must be in sufficient depth to clearly demonstrate that the Borrower and its Key Principals are creditworthy, have adequate financial strength to support the transaction, and appear likely to maintain that strength during the term of the Mortgage. In addition, the Lender must review the Principal's financial statements (which need not conform fully to the requirements of Section 605.01 of this Part) in sufficient detail to establish the Principal's solvency.

If the Lender's review of the financial condition of the Key Principals reveals that the Key Principals have satisfactory liquidity to support the transaction, the Lender need not perform the financial reviews required by Section 605.03 of this Part for the Principals. If, however, the Lender's review of the financial condition of the Key Principals reveals that the Key Principals do not have adequate financial strength and liquidity to support the transaction, the Lender must perform the full mortgage credit review required by this Chapter for Key Principals on one or more Principals until adequate liquidity and stability is established. References in this Chapter to the review level required for Key Principals apply equally to Principals who are relied upon for financial strength. Principals relied upon for financial strength need not execute the acknowledgment to the Note, but must be identified as "Key Principals" along with the Key Principal at the end of the Security Instrument.

III, 605.01: Documentation (11/06/03)

Unless otherwise provided in Section 605.04 of this Part for Tier 3 and Tier 4 loans, Fannie Mae requires that the Lender obtain the following information for each loan application:

a. Signed financial statements

From:	The Borrower entity and all Key Principals and Principals (except for a) in limited partnerships, a limited partner owning less than 25 percent; b) in general partnerships, a general partner holding less than 25 percent, if the Lender determines that such general partner is not actively involved in the decision-making or management of the Borrower; or c) in corporate entities, a person or entity holding less than 25 percent, if the Lender determines that such person or entity is not actively involved in the decision-making or management of the Borrower.
Type:	Either audited or unaudited statements are acceptable, unless Fannie Mae or the Lender requires audited statements.
Unaudited:	Unaudited financial statements may be up to 90 days old on the application date, but must be updated by either new or updated statements or a statement of no adverse change that is no more than 90 days old at Commitment. In cases where the financial statements are complex and the preparation of new or updated statements would impose an undue burden on the Principals or Key Principals, the Lender may waive the requirement that unaudited financial statements be no more than 90 days old on the application date, as long as a statement of no adverse change is obtained. In no case, however, should be unaudited financial statements be more than 12 months old at the time of Commitment.
Audited:	Audited financial statements may be up to 12 months old on the application date, but must be updated by unaudited statements that are no more than 90 days old at Commitment.

The financial statements must comprehensively and fairly summarize the Borrower's or Key Principal's financial condition. The statements must:

1. Include a schedule of real estate investments. This schedule must provide the following information about each property in which the Borrower or Key Principal, as applicable, has an ownership interest:

   (a) the name and location of the property;

   (b) the age of the property;

   (c) the number of units in the property, if applicable;

   (d) the ownership interest in the property;

(e) the estimated market value of the property;

(f) the amount (i.e., outstanding balance) and terms of any debt secured by the property, indicating whether the debt is recourse;

(g) the maturity date of any debt secured by the property;

(h) the amount (i.e., outstanding balance), maturity date, and terms of any unsecured debt of the property owner, indicating whether the unsecured debt is recourse;

(i) the property's annual net operating income (on an accrual basis); and

(j) the property's operating income after debt service (on an accrual basis).

2. List all other assets, including notes receivable from related entities, and an estimate of the market value of each asset and the basis for calculating value estimates.

3. List all liabilities and contingent liabilities, including debts under lines or letters of credit, personal guaranties, unmet obligations to partnerships or other entities and other obligations in the future (the amount and timing of all such obligations should be specified or described).

4. List any other factors that may materially impact the Borrower's or Key Principal's financial position immediately or during the term of the Mortgage.

The financial statements submitted by Principals need not contain every item listed above, as long as the Lender is satisfied that the financial statement adequately reflects the Principal's solvency.

b. Federal income tax returns

For the Borrowing entity, federal income tax returns must be obtained for transactions at all Tiers for at least the last two years (or for any lesser period that the Borrower has been in existence).

In Tier 1 transactions and for all single-asset waivers (see Section 602.02 of this Part), federal income tax returns must be obtained for at least the immediately preceding year for each Key Principal. Federal income tax returns are not required for Key Principals in Tier 2, Tier 3, and Tier 4 transactions unless the Lender determines that such additional verification is warranted.

Federal tax returns are not required for Principals at any of the four Tiers unless the Lender determines that such additional verification is warranted.

If audited financial statements are submitted by the Borrower or Key Principal, federal income tax returns are not required from the entity or person submitting the audited financial statement.

Where tax returns are required, if subsequent tax returns or requests for extensions are filed during the time the Lender is underwriting the loan, the Lender should obtain those most recent tax returns or requests for extensions. For example, if the application is submitted in February of 1997, the most recent tax returns will reflect 1995; if 1996 tax returns are filed in April of 1997, during the processing of the transaction, the Lender should obtain a copy of those returns.

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III, 605.02: Review of the Borrowing Entity (11/06/03)

The Lender must compare the income, expenses, and net operating income reported on the Borrower's tax returns to the Property's operating statements and to the Lender's own analysis. The Lender also must assess the stability of the cash flow generated by the Property and consider any trends in underwriting.

The Lender should review the financial statements, including balance sheets, of the Borrower to determine the present condition of the entity, to review its assets and liabilities, including such items as cash on hand or unpaid bills, and to note the significance of any accounts receivable from or notes payable to related entities (effectively, loans to or from partners). See Chapter 12 of this Part for special credit criteria for nonprofit Borrowers who intend to develop and own Multifamily Affordable Housing Properties.

For non-single-asset Borrowers, the Lender must perform a review of the Borrower which is substantially similar to that described in Section 605.03 of this Part for Key Principals.

Fannie Mae Multifamily/Delegated Underwriting and Servicing Guide/Part III: Underwriting (08/23/99)/III, Chapter 6: Mortgage Credit Reviews (11/06/03)/III, 605: Review of Financial Statements and Tax Returns (11/06/03)/III, 605.03: Review of the Key Principals (11/06/03)

III, 605.03: Review of the Key Principals (11/06/03)

For each Key Principal, the Lender must review each of the following areas in sufficient depth to be reasonably confident of the conclusions drawn. Where Key Principal tax returns have not been obtained, the verifications listed below which reference the tax returns are not required.

a. Liquid Assets

Liquid assets include cash and any assets which could be turned into cash very quickly. Liquid assets are the most easily reviewed and verified and may be the most significant assets since they indicate the ability of the Key Principal to provide immediate and ongoing support to the Property or to any other asset which experiences financial difficulty. The Lender need not verify every possible liquid asset (such as small checking accounts). However, in considering the adequacy of liquid assets, the Lender may not count toward liquid assets any assets which have not been verified.

1. Cash — The Lender must verify significant cash assets by obtaining verifications of deposit. The institution providing the verification also may be able to supply average balances over some period which would be helpful in determining the consistency and reliability of the cash asset. By dividing the interest income declared on the Key Principal's tax return by a reasonable rate of return, the Lender may verify the amount, general stability, and trend of the cash assets.

   In all cases, the Lender must request, with the verification of deposits, whether the cash is pledged as collateral or otherwise encumbered by any withdrawal restrictions. Encumbered assets should not be counted in the Key Principal's liquid assets.

   Retirement funds (adjusted for tax liability and withdrawal penalties) may be included in net worth, but may not be counted as liquid assets.

2. Stocks, Bonds, and Marketable Securities — The ownership and approximate value of stock and other marketable securities must be verified by the Lender before inclusion in liquid assets. The Lender must verify the ownership with a banker, broker, or similar source and list the source and date for determining the value of publicly traded securities. The Lender must include only the Key Principal's actual equity in any stock, and assure that the total value of stock purchased on a margin account is not included. The Key Principal's tax returns may be used to verify the ownership of dividend-paying stocks and marketable securities which have been held for more than a year and will indicate the consistency of such ownership by the Key Principal.

   Assets that cannot be reliably valued (i.e., through regular trading on an open exchange), such as stock in a closely held corporation, must not be considered in liquid assets.

3. Conclusion — Where any inconsistencies exist, such as financial statements that indicate significant cash assets and tax returns that indicate low interest income, the Lender must obtain a satisfactory explanation from the Key Principal.

   The Underwriter's Narrative must indicate the total amount of all verified liquid assets and must provide a brief description of the sources and verification of those assets.

b. Nonliquid Assets

Nonliquid assets are reviewed in order to establish the net worth of each Key Principal and to support the analysis of cash flow. Most importantly, however, the review must determine whether the Key Principal's portfolio contains properties or other business interests which are likely to compete for resources needed by the Property being underwritten or, in the worst case, are likely to cause the Key Principal, and possibly the Property, to experience serious financial difficulty.

The Lender must review all investments in which a Key Principal is a general partner, significant shareholder, or otherwise has significant ownership control and obligations.

1. Real Estate Owned — The Lender must verify that the properties listed on the schedule of real estate investments (see Section 605.01(a) of this Part) match the real estate reported in the Key Principal's tax returns. Disparities may be the result of oversight or recent transfers or may indicate intentional omission of poorly performing investments. Any such disparities must be explained.

   The Lender must review the reported value of each property and determine if the values appear reasonable by considering price per unit, gross rent multipliers, information from market sources, and/or the application of reasonable capitalization rates to reported income. Income from real estate owned directly may be compared against the income reported in the tax return, adjusted for capital improvements and depreciation.

   The Lender must consider the real estate leverage ratio (first mortgage and secondary debt, including any known loans from affiliates and accrued interest, divided by reasonable market value) of these properties. Properties which are highly leveraged are more likely to require capital infusions and may divert needed funds from the Property being underwritten. The leverage position should be suitable for the specific property. Older properties or properties in softer markets should be more highly capitalized than newer properties in stronger markets.

   The cash flow of each individual property should be reviewed and compared, to the extent possible, to the Key Principal's tax returns (adjusted for such items as depreciation and capital improvements). Any properties with negative cash flow must be investigated and the cause, anticipated future amount, and duration of the negative cash flow assessed. For properties with negative cash flow, or if determined necessary by the Lender, operating statements for the property must be obtained.

   Where the quality of a particular property is questionable, or where property information is not capable of otherwise being verified, the Lender may request additional information regarding that property. A complete financial statement for an individual property will provide a statement of cash flow summarizing the sources and uses of funds during the year. This statement will indicate capital contributions, distributions and any financings that may have transpired during the year. The presence of accrued interest or loans payable to related entities are also indicators that a property may be economically unsound and may compete for resources with the Property being underwritten or otherwise destabilize the Key Principal or the Property. If capital contributions or financings appear on this statement, the Lender must determine the reason such funds were required and the likelihood and magnitude of additional capital infusions in the future.

2. Partnerships and Subchapter S Corporations — The total number of partnerships in which the Key Principal is

a partner and the total number of Subchapter S corporations in which the Key Principal owns an interest should be identified. Each listing should indicate the Key Principal's percentage of ownership. The list of such holdings must be compared against the Key Principal's tax returns.

Leverage ratios and cash flows should be analyzed in the manner discussed above, considering the percentage of ownership of the Key Principal. Additional information, such as one or more years of tax returns of the partnership or corporation and operating statements of the properties involved, must be requested of the Key Principal if necessary and should be reviewed in all cases of negative cash flow (before depreciation).

3. Businesses Owned — For other businesses owned by the Key Principal, the Lender must consider the nature of the business, its general prospects and stability, leverage ratios and cash flow, and the significance of the business to the Key Principal's net worth. If the business makes up a significant portion of the Key Principal's net worth, produces a significant portion of the Key Principal's income, or has negative cash flow or disproportionate liabilities, the Lender should increase its due diligence to determine if the business is likely to compete with the Property for the Key Principal's resources or otherwise negatively impact the Property.

4. All Cases

In all cases, the Lender must:

(a) determine whether the method used to establish value is reasonable;

(b) consider the general economic health of the markets in which properties or businesses are located to establish the likelihood of continued good performance; and

(c) review any adjustable-rate debt or outstanding debt which will come due during the term of the mortgage to determine whether refinancing needs will destabilize the Key Principal. For example, a Key Principal who appears to be strong based on a snapshot of current holdings may become bankrupt because of a need to refinance vacant land which has dropped considerably in value since the current loan was made.

c. Cash Flow

After the above assessments, the Lender must analyze the cash flow of the Key Principal. The Lender must carefully review the stability of all sources of income and review any operating losses to determine whether these losses are likely to continue or increase in the future.

In addition to those discussed in a. above, other sources of cash flow, which can be verified and included in the total cash flow assessment, include:

1. Interest income — The Lender must verify the source and stability of interest income by reviewing the Key Principal's tax return. Interest income from notes receivable may not be included.

2. Dividend income — The Lender must verify the source and stability of dividend income by reviewing the Key Principal's tax return.

3. Wages — The Lender must verify the source and stability of any wages included by reviewing the Key Principal's tax return.

4. Other Income — The Lender must verify any such income by reviewing the Key Principal's tax return and the source of the income. Where applicable, the Lender's review must identify the percentage of the income source owned by the Key Principal and must establish the anticipated amount, durability, and reliability of that income.

Where there is any question as to adequacy of cash flow or liquidity, the Lender may perform further due diligence. Where any negative cash flows appear for any item in the Key Principal's portfolio, the Lender must consider not only the amount of any loss, but the cause and likely duration. For example, a minor one-time loss due to significant capital improvements or limited carry on vacant land may not have significant impact on the Key Principal or the Property. However, the same amount of loss used to fund operating deficits on an older property in a soft market may be indicative of more serious future losses. Where there is any doubt, the Lender should obtain and review operating statements and tax returns for more than one year to determine whether losses are increasing.

The Lender should also review the Key Principal's financial statements and business plans, if necessary, to determine if there are any likely future changes or activities which may drain cash resources. For example, the presence of vacant land in the Key Principal's portfolio may indicate an intent to develop the land in the near future. An active developer is likely to have a more unstable cash flow and a potentially heavier demand on cash resources than a passive investor with a stable portfolio. Such indicators should be discussed with the Key Principal and evaluated by the Lender.

d. Liabilities/Obligations

Finally, the Lender must review all obligations or liabilities, including contingent liabilities, to determine the likelihood of these items causing significant demands on the Key Principal's resources. The Lender's analysis should include consideration of:

1. any refinancings expected during the term of the Mortgage;
2. any general or limited partnership contributions or loans not yet made, but which the Key Principal is obligated to make (these obligations are often contained in Partnership Agreements, Shareholder Agreements, or Contribution Agreements); any other liability resulting from disposition or foreclosure of an investment or potential contributions to properties to avoid foreclosure;
3. any law suits against the Key Principal or any of his or her holdings which might result in financial judgments against the Key Principal;
4. any personal guaranties or personal recourse given as collateral;
5. the Key Principal's current and potential tax obligations; and
6. any similar circumstances which the Lender believes may adversely impact the Key Principal or the Property.

III, 606: Creditor's Rights -- Due Diligence Requirements (11/06/03)

Title insurance companies often either will not, or, in some states (such as New Mexico, New York, and Texas), are not permitted to provide title insurance coverage for losses because a Mortgage is invalidated as a fraudulent conveyance or otherwise violates bankruptcy or other creditors' rights statutory provisions. Because a loan that runs afoul of creditors' rights laws is voidable, the Lender must undertake some additional due diligence steps to protect itself and Fannie Mae against the invalidation of a Mortgage Loan under the U.S. Bankruptcy Code (particularly Section 548), the Uniform Fraudulent Conveyance Act ("UFCA"), the Uniform Fraudulent Transfer Act ("UFTA"), or similar state statutes or case law.

Either the UFCA or UFTA have been adopted in over half of the states and the law is often somewhat similar elsewhere. In those jurisdictions that have adopted the UFCA or UFTA, careful observance of the guidelines in this Chapter should enable the Lender and Fannie Mae to avoid transactions likely to result in a fraudulent transfer claim or, in some cases, to have a good faith defense. Some situations and state laws, however, will require the Lender to consult with its bankruptcy counsel or its counsel admitted to practice in the state in which the Property is located, or require the Lender to request a waiver from the Property Regional Office. **For all loans in Louisiana and Puerto Rico, the Lender must request a waiver from the Property Regional Office**.

Due diligence to show that the loan was made in good faith after careful review of the facts is needed to provide a defense to a fraudulent conveyance or fraudulent transfer type of claim. The Lender must obtain from the Borrower a Certificate in the form shown as Exhibit III-32, if the Borrower is a partnership, or Exhibit III-33, if the Borrower is a corporation. If the Borrower is an individual or any other type of entity, the Lender is required to prepare a Certificate which is similar to Exhibit III-32 or III-33, except modified for an individual or for the entity type. This Certificate should be reviewed as part of the Lender's credit review and held in the loan file. In completing the Certificate, the Borrower must explain specifically how the loan proceeds will be used and to whom they will be provided as well as the facts necessary to answer questions relating to both basic financial criteria (indicating that the Borrower is solvent and will not be made insolvent by undertaking the Mortgage) and the value of consideration connected to the purchase of the Property or the transfer of interests in the Borrower being made in connection with the Mortgage. At loan closing, the Borrower must execute the Certificate of Borrower (Form 4518). The Lender must verify that there has not been an adverse change in the information reported on the initial Borrower's Certificate. The Lender's Underwriter's Narrative must be expanded to include substantiation of the facts and show that the financial criteria and value of consideration issues discussed below have been addressed satisfactorily.

The Lender should keep in mind that the purpose of the creditors' rights law is to prevent an insolvent person or entity from removing assets from the reach of creditors or favoring some creditors over others in ways that prevent some creditors from getting their fair share of the debtor's assets. Transfers among family members or among entities owned, in whole or in part, by the same people or entities require special scrutiny to be certain that creditors are not losing access to value that otherwise would be available to them because of the transfer. Generally, the Lender should deem persons or entities to be "related" if they are family members or if one would be considered a Principal with respect to the other or is a relative of a Key Principal or Principal that is a general partner.

The Lender should not make any loan if it has reason to believe there is an actual intent by the Borrower or its Key Principals or Principals to delay, hinder, or defraud creditors.

If, based on the Borrower's Certificate and the other financial information obtained by the Lender in underwriting the loan, satisfactory financial criteria are not met or there are questions about the value of consideration, the Lender must submit a waiver request to the Property Regional Office setting forth the facts and the reasons why the loan should be acceptable. Advice of bankruptcy counsel satisfactory to Fannie Mae may be required in some circumstances.

III, 607: Overall Conclusion (11/06/03)

The Lender should develop a final conclusion regarding the credit history and financial position of the Borrower, each Key Principal, and Principal.

The Lender must consider for each Key Principal:

1. verified liquidity;

2. cash flow and stability of income;

3. net worth;

4. overall Debt Service Coverage Ratio and leverage ratio;

5. geographic and product diversity in the Key Principal's portfolio and any sensitivity to declining values and reduced cash flows; and

6. existing and potential cash drains and any refinancings expected during the term of the Mortgage.

The Lender must then consider the combined existing and potential resources and liabilities of all Key Principals along with the particulars of the proposed transaction. If the financial circumstances of the Borrower or Key Principals are unclear, or if substantial questions are raised about the ability to support the Property or to support the Property and other obligations in the Key Principals' portfolios, the Lender must do a full mortgage credit review (see Section 605.03 of this Part) of sufficient Principals to establish adequate credit strength, or the transaction must be referred to the Property Regional Office for review, or be rejected by the Lender, or the ownership entity restructured to increase its financial strength or reduce its potential problems.

If the Borrowing entity and the Key Principals appear to have adequate resources, the Lender must consider, among others, the following issues:

1. If the Key Principals' liquidity, cash flow, and leverage ratios are acceptable but relatively weak, a higher debt service coverage may be imperative.

2. If the Key Principals' net worth is high, but liquidity and cash flow, while acceptable, are relatively weak, full funding of Replacement Reserves may be imperative.

3. Loans above the Base Loan Amount should not be considered except where the Key Principals' net worth and liquidity are very substantial. If any Letter of Credit is required for a loan above the Base Loan Amount (or any other reason) and collateral must be posted for the Letter of credit, the resources of the owner or ownership entity should be considered after deducting the amount of the collateral.

4. With stronger Properties in stronger markets, relatively weaker financial profiles may be acceptable. With weaker Properties in less stable markets, or with Properties which have special features which might require substantial support from the ownership entity (such as a Property which may require capital improvements for marketing purposes alone, as opposed to simple repairs and replacements, or a Property with a single, significant commercial lease, or any Property with a loan above the Base Loan Amount) a stronger financial profile is required.

In addition, a proposed sources and uses statement, signed by the managing general partner or chief operating officer of the Borrower, as applicable, must be obtained. The sources and uses statement must list all the obligations of the Borrower to be satisfied as part of the transaction. The statement also must describe any promissory notes, all capital contributions, including contributions by the Key Principals and Principals, general partners, and controlling shareholders, and any debt that has been forgiven as part of the transaction.

If the statement of sources and uses indicates net proceeds to the Borrower or its Key Principals and Principals (i.e., a cash-out financing), and particularly if the cash-out equals or exceeds the Key Principal's or Principal's original equity investment, the Lender must consider whether the Borrower will continue to maintain and manage the Property adequately. In such cases, the Lender should generally require full funding of the Replacement Reserves and take particular care to assure that needed repairs are fully funded in a Completion/Repair Agreement. If the Lender has any doubt regarding the Borrower's ownership motivation, the Lender must either ensure the Borrower's commitment to the Property (e.g., by requiring that the Borrower retain equity in the Property or by requiring a full recourse Payment Guaranty from the Key Principals or Principals) or reject the transaction.

If net proceeds will be transferred to the Borrower or its Key Principals or Principals, or if the value of the Property substantially exceeds the consideration being paid by the Borrower for the Property or by the new investors for interests in the Borrower, the Lender's credit review must show that the assets of the Borrower exceed all its debts and that any reserves or other collateral needed to operate and maintain the Property are adequately funded.

The Lender's final and supporting conclusions about the Borrowing entity and its Key Principals and Principals, and the impact of the credit review on the structure of the transaction, must be discussed in the Underwriter's Narrative.

In all cases where the credit review raises serious questions about the acceptability of the ownership structure, or where the credit review itself is extremely difficult because of the complexity of the Borrower's, Key Principals', or Principals' financial structure or holdings, the transaction must be discussed with the Property Regional Office.