



Berkeley Point Capital Bethesda, MD

Multifamily Accelerated Processing Program Second and Delaware Project (Kansas City, MO)

**Office of Audit, Region 7
Kansas City, KS**

**Audit Report Number: 2018-KC-1003
September 27, 2018**



To: Mary V. Walsh, Director, Office of Multifamily Housing Programs,
Southwest Region, 6AHMLA

From: //signed//
Ronald J. Hosking, Regional Inspector General for Audit, 7AGA

Subject: The Lender Generally Underwrote the Second and Delaware Project Loan in
Accordance With HUD Rules and Regulations

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of the underwriting for the Second and Delaware multifamily project.

HUD Handbook 2000.06, REV-4, sets specific timeframes for management decisions on recommended corrective actions. For each recommendation without a management decision, please respond and provide status reports in accordance with the HUD Handbook. Please furnish us copies of any correspondence or directives issued because of the audit.

The Inspector General Act, Title 5 United States Code, section 8M, requires that OIG post its publicly available reports on the OIG website. Accordingly, this report will be posted at <http://www.hudoig.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at 913-551-5870.



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The Lender Generally Underwrote the Second and Delaware Project Loan in Accordance With HUD Rules and Regulations

Highlights

What We Audited and Why

We audited the lender, Berkeley Point Capital, and the underwriting for the Second and Delaware project loan. We initiated the review of the loan underwriting based on a previous review of the Second and Delaware project, which focused on the construction and development of the project. The almost \$46 million project is Federal Housing Administration (FHA) insured and sitting substantially incomplete near downtown Kansas City, MO, with no additional work being performed. The lender has disbursed approximately \$21 million for the development and construction of the project so far. Our audit objective was to determine whether the loan for the Second and Delaware project was underwritten in accordance with U.S. Department of Housing and Urban Development (HUD) rules and regulations.

What We Found

The lender generally underwrote the loan in accordance with HUD rules and regulations, except it did not ensure that the general contractor met FHA's experience requirements. The contractor did not meet the large loan requirement of mortgagee letter 2014-18. This deficiency occurred because a previous lender that completed the underwriting did not consider the contractor's lack of experience to be material. As a result, this could contribute to the loan going into default if the project is not completed.

The underwriting on this loan was completed by a different lender, which sold its FHA construction loan portfolio to Berkeley Point Capital. As of the issue date of this report, HUD was working with a new lender to issue a new loan to fund the completion of the project. This new loan would pay off the original loan held by Berkeley Point Capital. With the issuance of the new loan, Berkeley Point Capital would no longer be involved with the Second and Delaware project.

What We Recommend

We recommend that the Southwest Regional Director of Multifamily Housing require that the current or future lender ensure that the project uses a contractor that is proven to be qualified and capable of completing the project.

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Background and Objective

The Second and Delaware marketing website described the project as a 276-unit, luxury, loft, apartment community that combines sustainability, simple sophistication, and long-lasting construction, bringing a new level of urban living to Kansas City, MO. Using rigorous “passive house” energy-efficiency standards, the building would consume 90 percent less energy than standard buildings, making the project one of the most efficient buildings on the planet.

The general contractor permanently stopped work on the project in June 2017, and the project sits incomplete today.

In January 2016, the U.S. Department of Housing and Urban Development (HUD) insured the Second and Delaware’s mortgage for more than \$49 million under section 221(d)(4) of the National Housing Act. Section 221(d)(4) insures mortgage loans to facilitate the new construction or substantial rehabilitation of multifamily rental or cooperative housing for moderate-income families, the elderly, and the handicapped. Section 221(d)(4) insures lenders against loss on mortgage default and assists private industry in the construction or rehabilitation of rental and cooperative housing by making capital more readily available. Borrowers may use insured mortgages to finance the construction or rehabilitation of detached, semidetached, row, walkup, or elevator-type rental or cooperative housing containing five or more units. Eligible borrowers include public, profit-motivated sponsors; limited distribution, nonprofit cooperatives; builder-seller, investor-sponsors; and general borrowers.

Section 221(d)(4) is eligible for multifamily accelerated processing. The sponsor works with the multifamily accelerated processing-approved lender, which submits required exhibits for the preapplication stage. HUD reviews the lender’s exhibits and will either invite the lender to apply for a firm commitment for mortgage insurance or decline to consider the application further. If HUD determines that the exhibits are acceptable, the lender then submits the firm commitment application, including a full underwriting package, to the local Office of Multifamily Housing Programs hub or program center for review. HUD reviews the application to determine whether the proposed loan is an acceptable risk. Consideration includes market need, zoning, architectural merits, capabilities of the borrower, availability of community resources, etc. If the proposed project meets program requirements, the local Multifamily hub or program center issues a commitment to the lender for mortgage insurance.

Oppenheimer Multifamily Housing and Healthcare Finance completed the underwriting and loan execution in January 2016. On July 21, 2016, Berkeley Point Capital, our auditee, entered into a mortgage servicing rights purchase and sale agreement with Oppenheimer Multifamily Housing and Healthcare Finance to assume the section 221(d)(4) loan for the Second and Delaware project.

Berkeley Point Capital was a top five Federal National Mortgage Association and Federal Home Loan Mortgage Corporation lender in 2017, with a 30-year history and a servicing portfolio of

\$58 billion. Berkeley Point Capital and its affiliates offer a full complement of government-sponsored enterprise, FHA, Life Company, and Conduit products paired with extensive multifamily, affordable, student, and senior housing, along with healthcare expertise. This includes more than 3,300 loans in 49 States and represents more than 500,000 multifamily units and 68.3 million in square footage.

The lender had disbursed approximately \$21 million for the development and construction of the project at the time of the work stoppage.

Our objective was to determine whether the loan for the Second and Delaware project was underwritten in accordance with HUD rules and regulations.

Results of Audit

Finding: The Lender Generally Underwrote the Loan in Accordance With HUD Rules and Regulations, Except It Did Not Ensure That the General Contractor Met FHA's Experience Requirements

The lender generally underwrote the loan in accordance with HUD rules and regulations, except it did not ensure that the general contractor met FHA's experience requirements. This deficiency occurred because a previous lender did not consider the contractor's lack of experience to be material. As a result, this could contribute to the loan going into default if the project is not completed.

The Lender Generally Underwrote the Loan in Accordance With HUD Rules and Regulations

Our review of the underwriting file included the firm commitment application, calculation of the debt service coverage ratio, appraisals, market studies, the developer's prior experience and financial status, the general contractor's prior experience and financial status, the architectural and cost analysis report, credit reports, and court records. Berkeley Point Capital purchased the loan for the Second and Delaware project after Oppenheimer Multifamily Housing and Healthcare Finance completed the underwriting process. The lender generally underwrote the loan in accordance with HUD rules and regulations, except it did not ensure that the general contractor met FHA's experience requirements.

The General Contractor Did Not Meet FHA's Experience Requirements

During the firm commitment stage of the underwriting process, the general contractor submitted a resume that included the general contractor's previous experience. The Multifamily Accelerated Processing Guide, paragraph 8.3(J), requires the lender to review the contractor's previous experience. It requires the resume to show the level of experience needed to successfully complete the development of the project. Additionally, mortgagee letter 2014-18 states that contractors without substantial prior experience in multifamily, construction lease-up, and property operations and which have not previously successfully owned or developed other large multifamily projects would not qualify for a large loan under any of the insurance programs. The mortgagee letter defines a large loan as \$25 million or more. Further, it states that related experience in single-family development or in development of commercial properties is not an acceptable substitute for the required prior multifamily experience. Since HUD insured the Second and Delaware's mortgage for more than \$49 million, which met the requirements of a large loan, the general contractor should have met the experience requirements to be qualified.

At the time the contractor submitted a statement of contractor qualifications, they had contracts for two ongoing projects that met the large loan threshold. However, because they were not yet completed, the lender could not be certain that the contractor could successfully develop a large

loan project. The contractor's firm commitment resume included two previous HUD projects in which it filled the role of general contractor. The two contracts were signed individually for more than \$19.3 and \$16.6 million. The two projects were wood frame walk-up buildings, where the Second and Delaware project was a mid-rise concrete structure. Furthermore, these two other HUD contracts the contractor completed allocated 7.9% and 8.2% of their contracts for concrete work, respectively, but the Second and Delaware project allocated 29.6% of its contract for concrete. The two previously completed HUD contracts were not similar in size and scope to the Second and Delaware project.

The Lender Did Not Consider the Contractor's Lack of Experience To Be Material

During our review, we learned that the previous lender valued a contractor's locality over its previous experience. The lender stated that HUD had expressed some concern over using an out-of-area contractor because of problems it had encountered on previous projects that used out-of-State contractors. Additionally, the lender stated that it believed subcontractors would help fill any voids in the general contractor's lack of experience.

A New Loan Could Be Issued

The contractor's lack of experience could be a contributing factor if the project is not completed and the loan ultimately goes into default. The underwriting on this loan was completed by a different lender, which sold its FHA construction loan portfolio to Berkeley Point Capital. As of the issue date of this report, HUD was working with a new lender to issue a new loan to fund the completion of the project. This new loan would pay off the original loan held by Berkeley Point Capital. With the issuance of the new loan, Berkeley Point Capital would no longer be involved with the Second and Delaware project.

Recommendations

We recommend that the Southwest Regional Director of Multifamily Housing

- 1A. Require that the current or future lender ensure that the project uses a contractor that is proven to be qualified and capable of completing the project.

Scope and Methodology

We performed our audit work from January through May 2018 at our office in Kansas City, KS, except for one visit to the Berkeley Point Capital offices in Bethesda, MD, from January 30 through February 1. The audit period covered the period January 1, 2014, through January 31, 2016.

To accomplish our objective, we reviewed the underwriting file, which included

- the firm commitment application,
- the calculation of the debt service coverage ratio,
- appraisals,
- market studies,
- the developer's prior experience and financial status,
- the general contractor's prior experience and financial status,
- the architectural and cost analysis report,
- credit reports, and
- court records.

Additionally, we

- reviewed a HUD handbook, the Code of Federal Regulations, mortgagee letters, and the 2011 Multifamily Accelerated Processing Guide;
- interviewed HUD and Berkeley Point Capital staff;
- reviewed the loan file at Berkeley Point Capital;
- reviewed the general contractor's and architect of records' contracts;
- reviewed the purchase escrow and assignment agreement; and
- reviewed the regulatory agreement.

Oppenheimer Multifamily Housing and Healthcare Finance completed the multifamily accelerated processing underwriting for the Second and Delaware loan. We were unable to review its internal controls or interview its underwriting staff because it discontinued its FHA lending operations in 2016. We did not evaluate Berkeley Point Capital's internal controls because it did not underwrite the loan.

We conducted the review based on information contained in the Berkeley Point Capital project file, placing no reliance on systems Berkeley Point Capital used or maintained. The records we obtained from Berkeley Point Capital and reviewed for audit evidence were not computer generated or based. Therefore, we did not conduct an assessment of data reliability.

Except for the limitations on our review of internal controls, as described above, we conducted the audit in accordance with generally accepted government auditing standards. Those standards

require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective(s). We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Internal Controls

Internal control is a process adopted by those charged with governance and management, designed to provide reasonable assurance about the achievement of the organization's mission, goals, and objectives with regard to

- effectiveness and efficiency of operations,
- reliability of financial reporting, and
- compliance with applicable laws and regulations.

Internal controls comprise the plans, policies, methods, and procedures used to meet the organization's mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Relevant Internal Controls

We determined that the following internal controls were relevant to our audit objective:

- Controls over the underwriting process.

We assessed the relevant controls identified above.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, the reasonable opportunity to prevent, detect, or correct (1) impairments to effectiveness or efficiency of operations, (2) misstatements in financial or performance information, or (3) violations of laws and regulations on a timely basis.

Oppenheimer Multifamily Housing and Healthcare Finance completed the underwriting before our auditee, Berkeley Point Capital, purchased the loan. We did not evaluate Berkeley Point Capital's internal controls because it did not underwrite the loan. Accordingly, we do not express an opinion on the effectiveness of Berkeley Point Capital's internal controls.

Appendixes

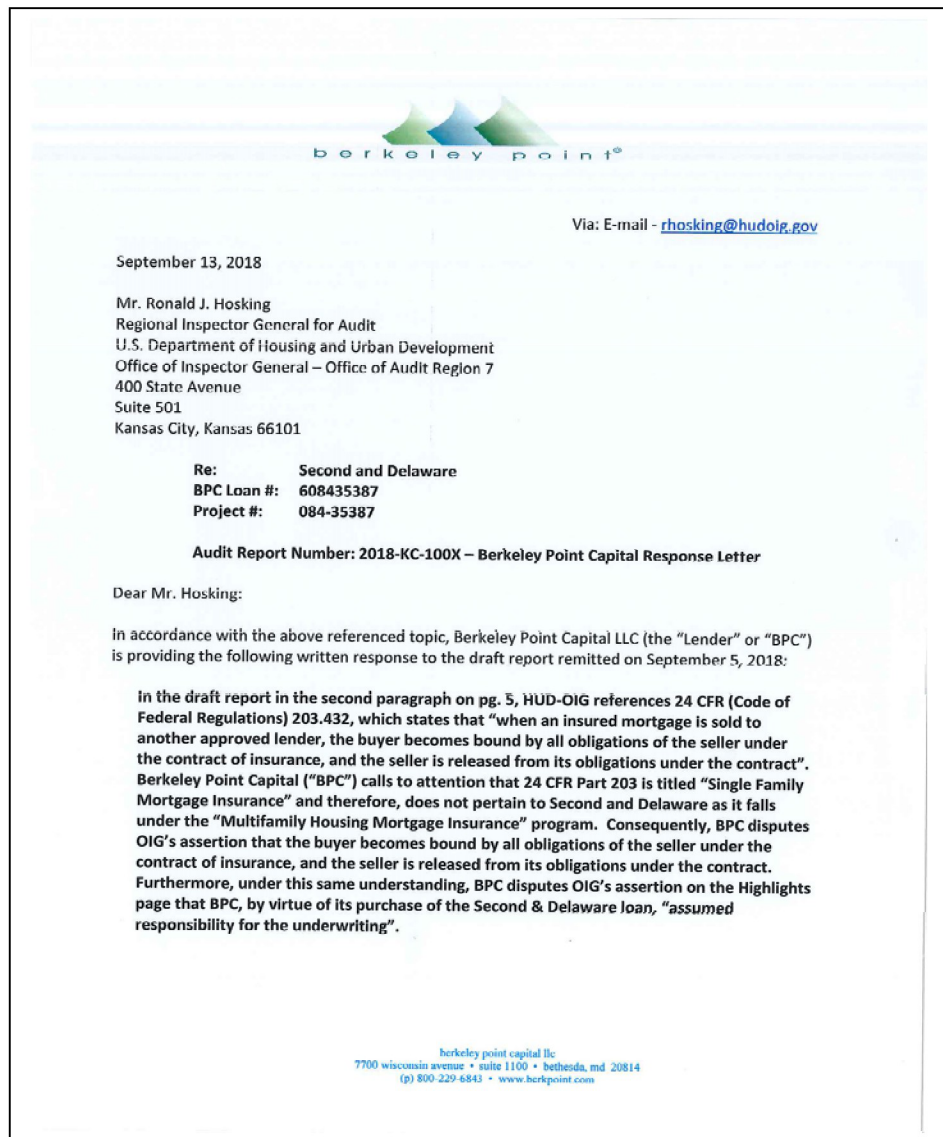
Appendix A

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

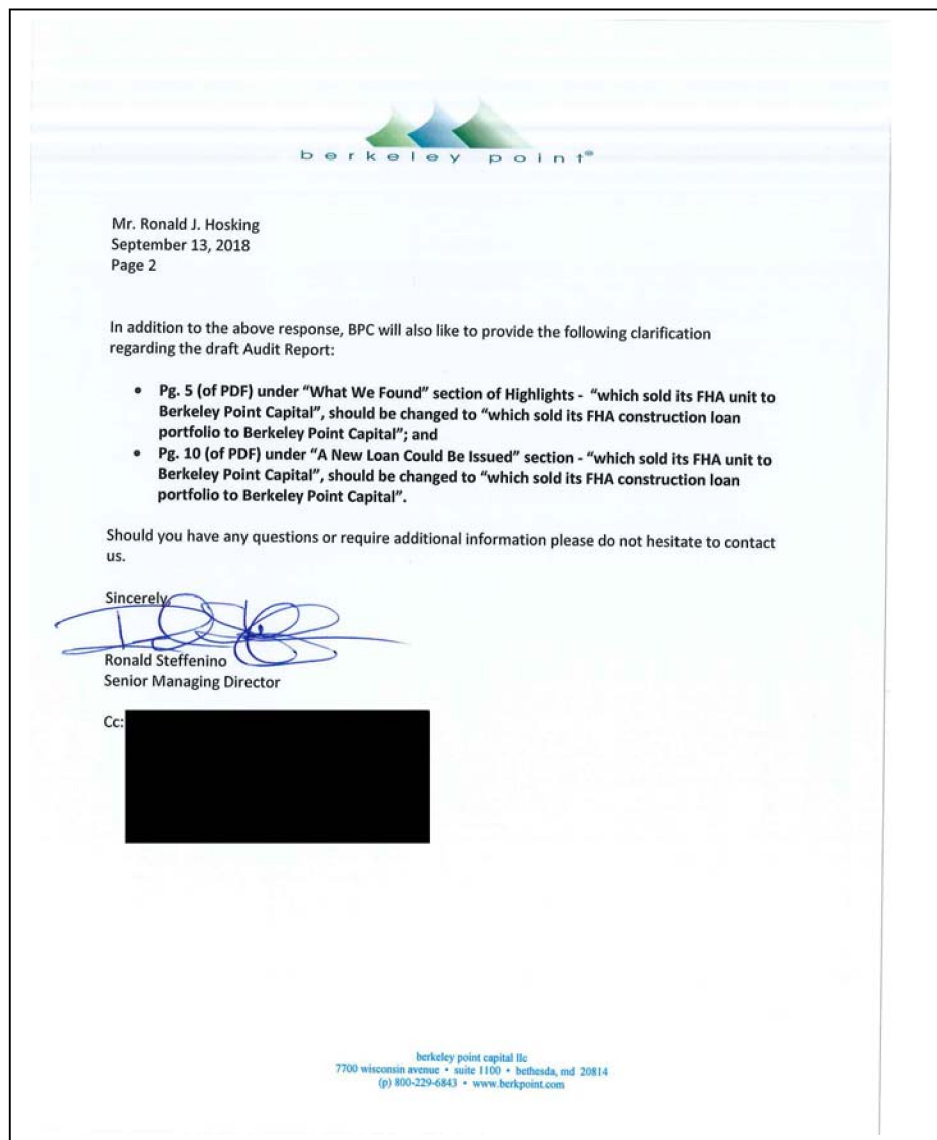
Comment 1



Ref to OIG
Evaluation

Auditee Comments

Comment 2



OIG Evaluation of Auditee Comments

- Comment 1 We agree that 24 CFR part 203 is only applicable to Single Family loans. We removed language in the report that says Berkeley Point assumed responsibility for the underwriting when it purchased Oppenheimer Multifamily Housing and Healthcare Finance's construction loan portfolio. This report makes no determination of liability for any potential damages.
- Comment 2 We made the suggested changes in the report.

Appendix B

Criteria

Multifamily Accelerated Processing Guide, Chapter 8.3

Section J – Analyzing the Borrower’s and Contractor’s Previous Experience

Subsection 1

The Lender’s underwriter must evaluate the resume of the principal(s). The principal must have positive experience and qualifications in developing, owning or building similar multifamily properties.

Mortgagee Letter 2014-18, Section III

Part D – Other Underwriting Requirements for Large Loans

The following underwriting and mortgage credit requirements apply to all Large Loans at or above \$25M under any of the rental housing insurance programs.

Subsection iii

Large Loan borrowers must have substantial prior experience developing, construction and owning multifamily projects that are similar in size and scope to what is proposed. Borrowers or contractors without substantial prior experience in multifamily, construction lease up and property operations, and who have not previously successfully owned or developed other large multifamily projects, will not qualify for a Large Loan under any of the insurance programs. Related experience in single family development or in development of commercial properties is not acceptable substitute for the required prior multifamily experience and may not be a basis for a waiver of the experience requirement.