Berkadia Commercial Mortgage, LLC, St. Louis, MO

Section 220 Multifamily Insurance Program

Office of Audit, Region 7
Kansas City, MO

Audit Report Number: 2015-KC-1005
August 4, 2015

To: Terry Clark, Branch Chief – Counterparty Oversight, HTNA

//**signed**//

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

Subject: Berkadia Approved a Mortgage for the Temtor Project That Was Not Economically Sound

Attached is the U.S. Department of Housing and Urban Development (HUD), Office of Inspector General's (OIG) final results of our review of Berkadia Mortgage, LLC's underwriting of the loan to fund the Temtor 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 Web site. 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.

Audit Report Number: 2015-KC-1005
Date: August 4, 2015

Berkadia Approved a Mortgage for the Temtor Project That Was Not Economically Sound

Highlights

What We Audited and Why

We audited Berkadia Commercial Mortgage, LLC's underwriting of the loan to fund the renovation of the Temtor project in St. Louis, MO. We initiated this audit because the project failed quickly after completion, resulting in a large loss to the Federal Housing Administration insurance fund. Our audit objective was to determine whether Berkadia properly underwrote the items that established the maximum mortgage amount for the Temtor project.

What We Found

Berkadia did not properly determine the maximum mortgage amount for the Temtor loan, resulting in an $11.3 million loss to HUD. Ineligible and unsupported items increased the U.S. Department of Housing and Urban Development (HUD)-insured mortgage by more than $6 million. Berkadia included projected commercial rents without establishing the market rate and tax increment financing (TIF) payments that were not guaranteed. The project's actual income was insufficient to pay the larger mortgage. The owners defaulted on the loan beginning with the first payment after final endorsement, leading to submission of a claim to HUD.

What We Recommend

We recommend that HUD refer Berkadia to the Mortgagee Review Board for the violations that caused a more than $11 million loss to HUD's FHA insurance fund. We also recommend that Berkadia modify policies and procedures to ensure that future loans represent an acceptable risk to HUD. These measures would include a documented review of third-party reports, written procedures to value TIF and tax abatement, and a process to evaluate the competence of the project management team.

Table of Contents

Background and Objective

Berkadia Commercial Mortgage, LLC, was organized as a Delaware limited liability company in August 2009. In December 2009, Berkadia began operations by acquiring the commercial mortgage origination and servicing business of Capmark Financial Group, Inc., and some of its subsidiaries. This report refers to Berkadia as the lender regardless of whether the activities discussed occurred before or after the acquisition of Capmark.

Berkadia originates commercial real estate loans for the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Government National Mortgage Association (Ginnie Mae), and the Federal Housing Administration (FHA), (collectively the agencies), using their underwriting guidelines, and sells the loans after they are funded. If Berkadia follows established underwriting guidelines, the agencies must purchase the principal amount of the loan and accrued interest. Berkadia retains the servicing rights. With respect to FHA loans, the U.S. Department of Housing and Urban Development (HUD) provides mortgage insurance coverage, and institutional investors purchase related Ginnie Mae securities.

Berkadia underwrote the HUD-insured loan to fund the renovation of the former Coca-Cola syrup plant, also known as the Temtor. The project also included a redevelopment of nine scattered sites located in the South Carondelet neighborhood of St. Louis, Mo. The combined project included 109 units and 37,845 square feet of commercial space and had an original mortgage amount of more than $14.4 million. HUD authorized the mortgage under Section 220 of the National Housing Act, which provides for substantial rehabilitation of multifamily rental apartments. Capmark submitted the application for firm commitment to HUD on July 7, 2009. After Berkadia acquired Capmark, it made several amendments and extensions to the firm commitment between December 2009 and March 2010. The appraisal was updated on March 29, 2010, and the project reached initial endorsement on April 1, 2010. After the rehabilitation was complete, the project reached final endorsement on January 30, 2012.

The lender is required to follow HUD's Multifamily Accelerated Processing (MAP) Guide, which provides mortgage insurance program descriptions, borrower and lender eligibility requirements, application requirements, HUD underwriting standards for all technical disciplines, construction administration requirements, and closing instructions. The lender determines the maximum mortgage amount by taking the lowest of three calculations: 1) 90% of the sum of the HUD estimated cost of repairs and rehabilitation and the as is value of the property (substantial rehabilitation), 2) a mortgage amount that does not exceed 90% of the project's estimated net income (which is known as 1.1 debt service ratio coverage) and 3) statutory per unit limits, adjusted by the Field Office high cost percentage. In this case, the debt service value (calculation 2), which is the project income divided by a discount rate, was the lowest amount and controlled the maximum mortgage amount.

Our audit objective was to determine whether Berkadia properly underwrote the items that established the maximum mortgage amount for the Temtor project.

Results of Audit

Finding: Berkadia Approved a Mortgage That Was Not Economically Sound

Berkadia did not properly determine the maximum mortgage amount for the Temtor loan. It did not have adequate controls to ensure that the loan was economically sound. The project's actual income was insufficient to pay the mortgage, leading to default and HUD's paying a $14.2 million claim.

Ineligible and Unsupported Items Increased the Mortgage by More Than $6 Million

Berkadia did not properly determine the maximum mortgage amount for the Temtor loan. Ineligible and unsupported income and payments were included in the calculation of the maximum mortgage amount. The ineligible and unsupported items increased the maximum insurable mortgage by more than $6 million.

Unacceptable Commercial Rent

Berkadia included commercial rent in projected income without establishing the market rent. The MAP Guide requires the appraiser to develop the market rent by comparison to properties as similar as possible in location, structural type, number of bedrooms, and average unit size. The appraisal defines market value as the price in a competitive and open market with both parties acting in their own best interest, with the price unaffected by sales concessions. The MAP Guide further required the lender to use due diligence in reviewing third-party reports, such as the appraisal.

The appraisal did not include adequate information to establish the market rent for commercial property in the primary market area and, therefore, did not justify using the projected commercial income to increase the maximum insurable mortgage. The Berkadia appraiser questioned the commercial rents in the appraisal. Specifically, she asked "whether the leases are arm's length transactions, what type of tenant improvements were included, etc." If Berkadia had investigated the issues raised by its appraiser during the review of the Coca-Cola syrup plant appraisal, it would have learned that four of the five comparable commercial properties used in the appraisal were not arm's-length transactions. In addition, it would have learned that one of the leases included several material concessions, including tenant improvements. Therefore, the appraisal did not reliably establish a market rate for the commercial property. However, Berkadia included the unreliable commercial rent amount of $262,940 in the projected annual net income. This addition increased the maximum mortgage amount based on the debt service ratio by more than $3.5 million.

Uncertain Income Inclusions

Berkadia increased the mortgage amount by including uncertain tax increment financing (TIF) payments in projected income. The mortgage amount based on the debt service ratio included

$238,777 in annual TIF payments. The MAP Guide does not provide guidance on how to process TIFs.

The City of St. Louis Web site explained that TIFs use new or incremental tax revenues generated by the project after completion. The TIF note indicated that the City's obligations on the TIF note would end in August 2031, regardless of whether the principal amount or interest had been paid in full. The TIF payments were not assured because they were contingent upon future events. Because the TIF payments were not assured, they should not have been used as a basis to increase the mortgage. The TIF payments increased the maximum mortgage amount based on the debt service ratio by more than $2.9 million.

Inexperienced Borrower Management Team

Berkadia approved a borrower management team that had no HUD experience to manage this complex project. The MAP Guide required the lender's underwriter to evaluate the resume of the principals and require the addition of members to the development team if necessary to satisfy experience requirements. The project owners and management agent disclosed that they had no previous HUD experience. The project required rehabilitation of a former industrial building that was more than 100 years old and had been largely vacant for more than 20 years and several commercial and residential properties that were more than 80 years old and had been vacant or underused in recent years. The management agent's resume indicated that this single project was larger than his entire previous portfolio. This fact is particularly important in determining the maximum insurable mortgage because the appraisal stated that it assumed responsible ownership and competent property management.

Berkadia Lacked Controls

Berkadia did not have adequate controls to ensure that the Temtor loan was economically sound. Specifically, Berkadia's procedures did not require adequate testing of items that increased the maximum insurable mortgage.

Inadequate Appraisal Review

Berkadia's procedures did not require an adequate appraisal review. The Berkadia appraiser identified significant concerns with the Temtor appraisal, which remained in the final report. These concerns included a failure to establish arm's-length commercial rent comparables. Berkadia's procedures did not require that the questions and comments raised by the loan reviewers be resolved. It required only that all changes be deemed satisfactory by the underwriter.

Inadequate Review of TIF Payments

Berkadia's procedures did not cover TIF payments. Berkadia's chief underwriter stated that tax abatement and TIF were handled the same way. Even if Berkadia added this unwritten procedure to the quality control plan it fails to recognize the underlying differences between tax abatements and TIF.

Insufficient Assessment of Project Management

Berkadia's procedures did not test the competence of the project management team. While its procedures generally directed the underwriter to evaluate the credit worthiness, experience, and character of the owner and management agent, they failed to adequately assess management experience and competence. The procedures specifically required a review of credit reports and public record searches, as well as a site evaluation of the subject's average time to lease, method of reaching a potential tenant base, deferred maintenance, and other important positive or negative attributes of onsite personnel. However, this process did not establish management's ability to control project costs. The review was not adequate as evidenced by the fact that the management agent had no written procedures for administering project funds.

The Project Defaulted, Leading to HUD's Paying a Claim

The project's actual income was insufficient to pay the mortgage, leading to default and HUD's paying a $14.2 million claim.

Insufficient Cash Flow

The owners defaulted on the loan beginning with the first payment after final endorsement when the project did not generate the projected income. On March 7, 2012, the project made a partial payment of the first mortgage payment, which was due on March 1, 2012. By December 2012, the unpaid mortgage payments totaled nearly $750,000.

The management agent was unable to lease the commercial space at the rent projected in the appraisal. Instead, he rented the property to his own business at a much lower cost. The appraiser projected that the commercial space would produce $7.20 per square foot or $262,940. The actual commercial space income was $2.51 per square foot, which produced $94,137. This amount included 7,246 square feet of space rented to a business owned by the management agent for $0.33 per square foot.

Actual TIF payments were less than the projected payments used to determine the maximum mortgage. The project received no TIF payments from the City until 2013. Because a large portion of the TIFs was based on generating commercial income, it was likely that TIF payments would continue to fall below projections.

The management agent reported excessive operating expenses and was replaced after 11 months of project operation. The former management agent stated that the new management company was larger and able to absorb some administrative costs. The actual operating expenses averaged $36,104 per month higher than projected expenses. These extra expenses reduced the net operating income by $397,144.

Loss to HUD

HUD paid a claim of $14.2 million after Berkadia assigned the mortgage to HUD. HUD later sold the note for $2.9 million, resulting in a loss of $11.3 million.

Conclusion

The Temtor project's actual income was insufficient to pay the mortgage. The owners defaulted on the loan beginning with the first payment, leading to submission of a claim and HUD's sustaining an $11.3 million loss. The MAP Guide requires the lender to certify that the loan is economically sound. Berkadia did not have adequate controls to ensure that the Temtor loan was economically sound.

Recommendations

We recommend that the Branch Chief – Counterparty Oversight

1A. Refer Berkadia to the Mortgagee Review Board for appropriate action for violations that caused a more than $11 million loss to HUD's FHA insurance fund.

1B. Require Berkadia to modify policies and procedures to ensure that future loans represent an acceptable risk to HUD. Berkadia should include a documented review of third-party reports, written procedures to value TIF and tax abatement, and a process to evaluate the competence of the project management team.

Scope and Methodology

We performed audit work from November 2014 through May 2015. We conducted audit fieldwork at Berkadia's office at 12444 Powerscourt Drive, Suite 400, St. Louis, MO. Our audit period covered January 1, 2009, to April 1, 2010.

To accomplish our objective, we

- Reviewed relevant regulations and HUD guidance;
- Reviewed Berkadia's quality control plan (Berkadia was not able to provide Capmark procedures);
- Reviewed the request for firm commitment to underwrite this loan submitted by Berkadia,
- Reviewed the property appraisal and the associated findings of HUD's Lender Qualification and Monitoring Division and the contract appraiser hired by Berkadia to review the original appraisal;
- Reviewed the TIF and tax abatement included in the calculation of the maximum insurable mortgage; and
- Interviewed Berkadia staff, project appraisers, and HUD Staff.

We obtained the request for firm commitment and the associated documents submitted by Berkadia. We reviewed the application for a multifamily housing project and the supplement to the project analysis. We determined that the maximum insurable mortgage was limited by the debt service ratio of the project.

We reviewed the projected cash inflow amounts that were used to determine the debt service ratio. These amounts included net income of the project, TIF payments, and tax abatement. The appraisal provided the projected net income value used in the application. We reviewed the appraisal and interviewed the third-party appraiser and the HUD review appraiser. We researched the ownership of the commercial comparables using public records and obtained a copy of the lease of the largest property.

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 to ensure compliance with the multifamily accelerated processing program underwriting requirements.

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.

Significant Deficiency

Based on our review, we believe that the following item is a significant deficiency:

- Berkadia did not have adequate procedures to ensure that the Temtor loan was economically sound.

Appendixes

Appendix A

Schedule of Questioned Costs

Recommendation number	Unreasonable or unnecessary 1/
1A	11,312,956
Totals	**11,312,956**

1/ Unreasonable or unnecessary costs are those costs not generally recognized as ordinary, prudent, relevant, or necessary within established practices. Unreasonable costs exceed the costs that would be incurred by a prudent person in conducting a competitive business. We determined the unreasonable cost to be the loss to the FHA fund of $11,312,956. We calculated the loss incurred by HUD by subtracting the proceeds of the note sale of $2,876,000 from the claim paid by HUD of $14,188,956. We calculated the net loss to be $11,312,956.

Appendix B

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation | **Auditee Comments**

Ballard Spahr LLP

1909 K Street, NW
12th Floor
Washington, DC 20006-1157
TEL 202.661.2200
FAX 202.661.2299
www.ballardspahr.com

Constantinos G. Panagopoulos
Direct: 202.661.2202
Fax: 202.661.2299
cgp@ballardspahr.com

July 6, 2015

Ronald J. Hosking
Office of Inspector General
United States Department of Housing and Urban Development
Regional Inspector General for Audit
Office of Audit (Region 7)
Gateway Tower II, 5th floor
400 State Ave.
Kansas City, KS 66101-2406

Re: Response to HUD Office of Inspector General Draft Audit of Temtor

Dear Mr. Hosking:

Comment 1

This letter is in response to the HUD Office of Inspector General's ("OIG") request that Berkadia Commercial Mortgage LLC ("BCM") comment on its June 17, 2015 draft audit report ("Draft Report"). The Draft Report relates to the underwriting by Capmark Finance Inc. ("CFI") of the section 220 HUD-insured loan ("Loan") to fund the renovation of the former Coca-Cola plant and redevelop nine scattered sites in St. Louis, MO (the "Project" or "Temtor"). BCM made the Loan under HUD's Multifamily Accelerated Processing ("MAP") Program. CFI underwrote the loan and submitted the loan to HUD. HUD reviewed the CFI underwriting package for the Loan and issued a firm commitment. The Loan was transferred prior to closing to BCM as a part of an asset sale in CFI's bankruptcy case.[1]

I. Introduction

Comment 2

The conclusions and recommendations in the Draft Report are flawed in several respects. First, OIG auditors who have never underwritten loans utilizing the Multi-Family Accelerated Processing Guide ("MAP Guide") have referenced obsolete and/or inappropriate standards and have misconstrued or failed to consider the appropriate sections of the MAP Guide and instead, improperly substituted their own post hoc judgments as to how a loan should be underwritten.

[1] The OIG's discussion draft of the audit failed to distinguish between the actions of CFI and BCM. During the exit conference the OIG agreed to correct the report to distinguish between the two entities..

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 2

Comment 1

Second, the Draft Report fails to acknowledge HUD's significant role in underwriting and approving the Loan. For example, HUD reviewed and approved underwriting-related documentation and certified that the third-party reports (that the OIG now criticizes) complied with HUD requirements.

Third, the Draft Report ignores the conclusions of a loan default review ("LQMD Review") conducted by Novogradac and Company, LLP ("Novogradac"), an independent third party, which concluded that the loan was underwritten in accordance with MAP Guide standards.[2]

Finally, the OIG does not analyze or even mention the significant events that caused the Project to fail which were not foreseen by HUD, CFI or BCM and which were beyond their control. For these reasons, BCM requests that the OIG revise its report to correct these significant flaws or that it withdraw the Draft Report and close the audit altogether.

Comment 3

A. The OIG has ignored the requirements of the MAP Guide and is improperly substituting its own post hoc judgment as to how the Temtor loan should have been underwritten

The principal flaw in the Draft Report is that the OIG improperly substitutes its judgment in place of the specific requirements of the MAP Guide. The OIG fails to acknowledge HUD's significant role in underwriting a loan under the MAP Guide. Under HUD's Map Program, approved lenders prepare, process, review, and submit loan applications for multifamily mortgage insurance. The lender submits the firm commitment application, including a full underwriting package, to HUD to determine whether the loan is an acceptable risk. If HUD determines that the project meets program requirements, it issues a firm commitment to the lender for mortgage insurance.

While the stated objective of the Draft Report is to determine "whether [the Lender] properly underwrote the items that establish the maximum loan amount for the Temtor project," the OIG fails to consider the appropriate provisions of the MAP Guide in its review. For example, the OIG does not cite to any specific provisions of the MAP Guide in the body of its three-page analysis that support any of the conclusions reached. Instead, the OIG excerpts some parts of the MAP Guide in an appendix to the Draft Report without explanation as to how those excerpts support the conclusions in the Draft Report. In addition, the citations are incomplete and fail to outline the responsibilities of the various parties in a MAP transaction. A more complete review of the relevant provisions of the MAP Guide demonstrates the weaknesses in the OIG's analysis.

[2] HUD's Lender Qualifications and Monitoring Division analyzed the LQMD Report, reached its own conclusions regarding the underwriting of the Loan and communicated those conclusions to BCM. Because HUD has already reviewed and dealt with any perceived underwriting issues, no additional action by HUD is either necessary or appropriate.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 3

The relevant provisions outlining Lender qualifications, lender responsibilities and HUD responsibilities are found in chapters 8.1, 11.1 and 11.2 of the MAP Guide.

Comment 4

1. Lender Underwriting Qualifications and Responsibilities

The MAP Guide identifies the lender's qualifications as follows:

A. Lender Qualifications

1. The Lender's underwriter must have basic knowledge and skills in a variety of financial areas, including

a. General experience in banking, accounting, finance, or commercial lending, and in multifamily mortgage financing.

b. The ability to analyze corporate financial statements, including, but not limited to, balance sheets, income statements, and statements of changes in financial position, and to evaluate the credit acceptability of individuals, partnerships, corporations and other entities.

c. A broad knowledge of lending practices for mortgages and construction loans and the financial structures of individuals, partnerships and other entities.

As detailed above, the Map Guide does not require that lender's underwriter be a certified appraiser who is qualified to conduct a technical review of the third-party appraisal. Instead, the MAP Guide requires the lender's underwriter to be a generalist who understands lending practices. A review of the lender's duties during underwriting confirms that conclusion:

a. Duties and responsibilities associated with the application underwriting are as follows:

(1) Makes a determination of the acceptability of the general contractor, the sponsor, the mortgagor, if formed, and its key principals through a thorough analysis of their credit, character, financial

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 4

condition, motivation for ownership, availability of assets for closing and adequacy of income for total obligations.

(2) Uses trade references, bank references, credit data and construction experience resumes in analyzing the construction capability of the general contractor including financial stability, and ability to complete the project.

(3) Determines the recommended maximum mortgage amount and other key terms of the loan.

With respect to an appraisal, as detailed below, the Map Guide requires that the lenders hire a qualified appraiser to appraise the property. The lender then reviews the report to ensure that it contains the information required by Chapter 7.4 of the Map Guide.

Comment 4

Specifically, section 11.1C of the MAP Guide, requires the Lender to (i) review[3] the appraisal report, (ii) hire a well-qualified appraiser, (iii) confirm that the forms were prepared as required by the MAP Guide, and (iv) conclude, based on the information provided, that the loan presents an acceptable risk to HUD.[4] The MAP Guide does not ask the Lender to substitute its own

[3] The review in question is a general review of the appraisal to confirm it contains the information necessary for the underwriting analysis and not a detailed technical review. No other conclusion is possible for two reasons. First, as discussed above, the lender is not required to be a qualified appraiser. Second, as discussed below, the MAP Guide requires HUD to perform a technical review of the third-party reports.

[4] Section 11.1C provides:

Due diligence. With the Firm Commitment package the MAP Lender certifies that:

1. The Lender has reviewed all in-house and third party forms/reports/reviews.

2. The preparer of the forms/reports/reviews is qualified as required by the guide, and has the insurance, if any required by this guide.

3. The forms/reports/reviews were prepared in the manner required by the guide and the forms/reports reviews are complete and accurate.

4. The proposed loan represents an acceptable risk to the Department (replacement cost programs) or is economically sound (value programs), based upon the Lender's review and analysis and the proposed loan and processing complies with all FHA statutory regulatory and administrative requirements.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 5

judgment in place of the appraiser's. In fact, such practice would be questionable as discussed below.

2. HUD's Underwriting Responsibilities

Comment 5

By contrast, HUD has more significant responsibilities relating to the third-party reports. Chapter 8.1 outlines HUD's underwriting responsibilities as follows:

C. Major Duties and Responsibilities of HUD

1. HUD is to perform the following major mortgage credit functions during the application underwriting and construction periods:

a. During application underwriting:

(1) Reviews the Lender's mortgage credit report(s) regarding the acceptability of the sponsor, mortgagor, and its key principals, and the contractor.

(2) Performs HUD 2530 Clearance Process.

(3) Determines the maximum mortgage amount and other key terms of the loan.

(4) Determines actual financial settlement requirements.

(5) Reviews initial and final closing documents for compliance and acceptability.

Chapter 11.2B of the MAP Guide, entitled "HUD Field Office Underwriting Review" sheds additional light on HUD's role in the process by outlining the significant technical review of the third-party reports required by HUD:

HUD Reviewers Signature and Certifications: Upon determination of acceptability for processing, the HUD reviewers should sign their individual Technical Reviews and when

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 6

> determined acceptable for processing, the Master HUD 92264 prepared by the lender. The Master HUD 92264 is the most critical underwriting document because it is a summarization of key technical processing conclusions which, along with the HUD Form 92264A, are the basis for the FHA Firm Commitment. Since MAP requires a technical review of the lender's underwriting conclusions, the Master HUD Form 92264 is the logical and appropriate form that HUD reviewers should sign or co-sign to authenticate their review as opposed to individual 92264s prepared by third party contractors.... Long before the implementation of MAP, it has been an FHA basic procedure to require the HUD review appraiser's signature on the aforementioned forms. The Department believes that the continuation of this long standing policy clearly documents the underwriting conclusions and decisions made by HUD staff.... HUD review appraiser signatures, on such Forms as the 92264, attest to the quality of the review, that the processing is in compliance with MAP technical instructions, that it is free of errors and has no omissions, and that the appropriate appraisal procedures and analysis have been completed. Additionally, as the MAP Guide currently states, MAP requires a Technical Review of appraisals.
>
> * * *
>
> The HUD's review appraisers' technical review should comply with USPAP Standard 3. To document his review, the review appraiser should complete Appendix 7C.1 and the review report must include a signed certification as prescribed by USPAP Standard 3.

The review standards set forth in USPAP Standard 3 are rigorous. For example, USPAP Standards Rule 3-3(a) requires a review appraiser to "develop an opinion as to whether [the appraiser's] analyses are appropriate ... [and the appraiser's] opinions and conclusions are credible. The review appraiser must also develop the reasons for any disagreement. USPAP Standards Rule 3-3(b) requires a review appraiser to "develop an opinion as to whether the report is appropriate and not misleading ... [and to] develop the reasons for any disagreement."

The HUD review appraiser must document the technical reviews conducted by completing the form located in Appendix 7.C.1 of the Map Guide for the market study and in Appendix 7.C.2 of the Map Guide for the appraisal.

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 7

Comment 6

During the pre-application stage the HUD review appraiser must certify, based on the technical review HUD conducted, that the market study:

- complies with the MAP Guide; and
- provides evidence of market need of the proposed number of units/beds and rents;

The HUD review appraiser must also certify that the market rent estimate:

- uses a minimum of three comparables;
- uses comparables that are competitive with the Project;
- identifies and properly adjusts for all services and amenities to be provided;
- provides a narrative explanation for amenity and service adjustments; and
- conforms with the MAP Guide.

See MAP Guide, Appendix 7.C.1.

At the firm commitment stage the HUD review appraiser must certify, based on the technical review HUD conducted, that:

- the lender's appraiser is a MAP Guide qualified appraiser;
- the appraisal conforms to all the requirements of the MAP Guide;
- the appraisal includes narratives that support all conclusions and estimates;
- the estimated income, total operation expenses, total estimate replacement cost, and the maximum insurable mortgage are acceptable;
- the appraiser estimated an operating deficit period;
- the appraiser calculates the estimated operating deficit based on MAP Guide instructions; and
- the operating deficit calculated is acceptable.

See Map Guide, Appendix 7.C.2.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 8

Comment 6

MAP Guide Chapter 11.2F further requires HUD to review the transaction itself to confirm that the lender's underwriting was supportable and that the transaction represents an acceptable risk to HUD:

> **Underwriting recommendation**. Each HUD technical specialist by discipline would review the respective Lenders' reviewers' reports, the underwriting summary and certain key elements of the application specified in the Guide. The HUD technical specialist would review the quality of the Lender's review and the transaction itself. The HUD technical specialists would not reprocess the case. However, if the technical specialist determines that certain underwriting conclusions are not supportable and affect HUD's risk, the specialist would recommend modification of the Firm Commitment application, recommend that the Lender modify the application or recommend a rejection.

Once HUD completes its technical review, Chapter 11.2F obligates HUD to draft a memorandum summarizing the multiple technical reviews of the underwriting package and to determine whether to recommend the loan for approval:

> Upon completion of the technical reviews and the environmental assessment, the Team Leader will prepare a memorandum to the director summarizing the individual reviews of the specialists, any proposed waivers of FHA underwriting requirements and the Team Leader's overall recommendation.
>
> * * *
>
> Attached to the memorandum will be . . . . specific HUD staff reviews, the Lender narrative summary, the Lender's technical reviews and, if recommended for approval, a proposed FHA Firm Commitment with Forms 92264 and 92264a signed by the HUD reviewers and Team Leader.

CFI and HUD both fulfilled their respective obligations under the MAP Guide in underwriting the Loan. CFI provided the required documentation to HUD, including the third-party reports as outlined above.

HUD analyzed the information provided by CFI and determined that it complied with HUD requirements and supported the proposed Loan. HUD reviewed all the information and ultimately decided that the underwriting complied with the MAP Guide and supported the

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 9

proposed Loan. HUD then concluded that the proposed loan was an acceptable risk to HUD and issued a firm commitment.

Comment 7

Despite both CFI's and HUD's satisfaction of their respective requirements under the MAP Guide, the OIG has in 2015 chosen to second-guess the judgments that CFI and HUD professionals made several years ago during the underwriting process – judgments that were based on reports of independent, HUD-approved appraisers and analysts.[5]

Comment 8

B. HUD certified the accuracy and appropriateness of the judgments that the OIG now cites as evidence that CFI did not properly underwrite the Loan

As set forth above, HUD fulfilled its responsibilities for the Loan by reviewing the underwriting and third-party reports and concluded that the underwriting and the third-party reports that the OIG now criticizes complied with both the Uniform Standards of Professional Appraisal Practice ("USPAP") and with applicable MAP Guide requirements. HUD certified compliance utilizing MAP Guide Appendix forms 7.C.1 and 7.C.2.

Comment 9

C. Novogradac, an independent reviewer concluded that the Lender complied with MAP Guide requirements in underwriting the loan

Novogradac, a consulting firm that, among other things, reviews loans that go into early default was retained by BCM to conduct a quality control review of the defaulted loan. Novogradac completed its review of the Temtor Project and provided a written report to BCM on February 7, 2013 (the "Novogradac Report"). The Novogradac Report was then provided to HUD on February 15, 2013 as part of the default review process. HUD reviewed the Novogradac Report and acknowledged Novogradac's conclusions that:

- The Lender's Narrative was performed in accordance with MAP Guide instructions in effect at the time the loan was underwritten.
- The Mortgage Credit Analysis was performed in accordance with Chapter 8 of the MAP Guide as well as Handbook 4470.1.
- Underwriting and processing complied with the applicable provisions of the National Housing Act, Title 24 of the Code of Federal Regulations, the MAP Guide, the MAP Forms Book and MAP FAQs.
- The Quality Control Plan was compliant with the MAP Guide.

[5] The appraisers and analysts were approved by HUD at the commencement of underwriting.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation	Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 10

Comment 10

The Novogradac Report also concluded that there were weaknesses in the appraisal conducted by the third-party appraiser retained to appraise the property during underwriting. Significantly, neither Novogradac nor HUD attempted to blame CFI or BCM for the deficiencies in the appraisal. Indeed, HUD asked BCM to direct the third-party appraiser to address the issues identified in the Novogradac Report. It is clear therefore, that both HUD, which administers the MAP program and Novogradac, which conducts numerous reviews of MAP Projects, understood that, contrary to the OIG's assertions in the Draft Report, the Lender was not responsible for the third-party expert's conclusions. In fact, an appraiser permitting a client to interfere, second-guess, and edit an appraisal in the manner suggested by the OIG in the Draft Report would most likely violate the USPAP Ethics Rule, which requires an appraiser "to perform assignments with impartiality, objectivity, and **independence**."

Comment 11

D. The OIG failed to consider numerous factors that led to the Temtor default.

In addition to the significant flaws identified above, the OIG also failed to consider whether factors other than underwriting caused the default on the Loan. The underwriting, submission, and administration of a HUD-insured loan is a complex process involving, among others, numerous third-party professionals and analysts, contractors, a lender, and HUD. In addition, circumstances can change during the development and construction process that cause delays or increase costs. Moreover, market conditions may change during the period between underwriting and occupancy. All of these changes can significantly impact the viability of a Project. If loans like this were risk-free, the HUD insurance program would not be necessary.

Indeed, with respect to Temtor, numerous external factors, not anticipated by HUD, CFI or BCM, caused the default. For example, as noted in an August 8, 2013 HUD OIG Report, the borrower disbursed over $700,000 in ineligible and unsupported payments from its project account. In addition, the Project incurred significant delays due to construction disputes and water intrusion. Finally, the United States suffered through the worst recession since the Great Depression. At that time of commitment and closing, nobody predicted that the recession would last as long as it did. The different economic climate when the project opened created headwinds that were unanticipated at the time of closing.

1. Borrower Diverted Funds

Less than two years ago, the same OIG Region that issued the Draft Report conducted an audit to determine whether the borrower used Project funds for ineligible expenses. In Audit Report 2013-KC-1003, the OIG concluded that:

> The Temtor used project funds for ineligible and unsupported expenses. The misuse included payments of developer fees, unsecured loans, and excessive funds to the management agent. In addition, Temtor transferred

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

funds out of its tenant security deposit reserve account and submitted incorrect accounting reports that concealed the transfers.

The OIG found that the Temtor inappropriately paid $282,000 in developer fees, $69,000 for unsecured loan payments, $50,000 in excessive payments to the management agent, and an additional $316,000 in unsupported payments from project accounts. The OIG concluded that "Temtor chose to use project funds to benefit project owners rather than making the mortgage payment." The OIG further concluded that "more than $700,000 used to make improper payments was no longer available to make mortgage payments, contributing to the project's default." Unfortunately, in the Draft Report, the OIG completely ignores its previous conclusion that the improper diversion of over $700,000 contributed to the Project default.

2. Construction Delays

The Temtor project was also impacted by significant construction delays. Specifically, the owner and contractor were involved in disputes over progress payments and the quality of the contractor's work (notably water intrusion on one side of the project). HUD acknowledged in its own default review of the Project that construction delays and water issues caused a 6 month delay in the completion of the Project and contributed to the default.

The OIG's (1) substitution of its own standards in place of the MAP Guide standards, (2) failure to consider HUD's role in reviewing and approving both the underwriting of the Project and the third-party reports at issue, (3) failure to address the Novogradac Report and HUD's Default Review, which concluded that the Lender complied with MAP Guide requirements, and (4) failure to consider the actual causes of the default of the Project demonstrate that the Draft Report is seriously flawed. As set forth in more detail below, the OIG's specific findings are also unsupported.

3. Economy

It is undisputed that the United States suffered through a significant recession. At the time of commitment and closing of the loan no one could have predicted the length or the depth of the recession. Those effects were not considered or mentioned by the OIG.

II. THE PROPOSED OIG FINDING THAT BCM DID NOT PROPERLY DETERMINE THE MAXIMUM MORTGAGE AMOUNT FOR THE TEMTOR LOAN IS WRONG

The 21-page Draft Report contains very little analysis explaining the OIG's draft findings. The entire analysis is set forth in pages 4, 5 and 6 of the Draft Report. While the Draft Report should be revised or withdrawn based on the above analysis alone, BCM will also address each of the OIG's specific assertions below.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 12

A. The Lender utilized appropriate commercial market rents.

Comment 12

The OIG contends that the lender "included commercial rent in projected income without establishing market rent." This assertion is false. The assertion appears to be based on the OIG's erroneous conclusion that the Lender was required to look behind, second-guess and/or edit the appraisal report. As set forth above, that position is inconsistent with the MAP Guide and the USPAP Ethics Rule. As noted by the OIG, CFI (not BCM) reviewed the draft appraisal and provided nine pages comments to the appraiser. Thereafter, the appraiser, utilizing his own professional judgment and independence, decided which of CFI's comments he would accept and finalized and issued his appraisal. [6] HUD reviewed and approved that final appraisal utilizing USPAP technical review standards as required by MAP Guide Chapter 11.2F and Appendix 7.C.2. CFI, therefore, was absolutely entitled to rely on the third-party report approved by HUD prepared by an appraiser who was also approved by HUD.

In any event, the appraisal appears to use acceptable comparables for the Primary Market Area to establish the market rent for commercial property. The comparables appear consistent with the area and include typical adjustments for the area. The OIG fails to identify any other comparables in the area that it believes should have been used.

The OIG's allegation that four of the five comps "were not arms-length" because the commercial properties were owned by borrower-related entities misses the boat. While the owner of the commercial properties used as comparables may have been related to the borrower, many of the leases which were used to determine the underwritten rate were at arms-length with the actual tenants of the commercial space (who were not related to the Borrower).

Finally, there is no prohibition in the MAP Guide to using properties as comparables to establish market rents or expenses that are included in the borrower's current portfolio. Given the area, the borrower's current real estate portfolio offered the best comparables and access to lease information for the PMA. As noted above, the OIG fails to identify any other comparables in the area that it believes should have been used.

Comment 13

[6] The comments were provided by CFI before the Loan was transferred to BCM. The employee who provided the comments is not employed by BCM. BCM could not find any record of the specific discussions between CFI's appraisal reviewer and the appraiser and thus cannot comment on the reasons that the appraiser chose to make some suggested changes and not others.

Auditee Comments and OIG's Evaluation

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 13

B. The Lender did not improperly increase the mortgage amount by including TIF payments in projected income.

The OIG notes that the MAP Guide allows a tax abatement to be used to increase a mortgage amount under certain conditions. The OIG concludes that a tax abatement must be "assured and secure" to increase a mortgage amount and cites to a HUD FAQ on tax abatement and HUD Handbook 4420.1. There are several problems with the OIG's analysis. First, the OIG appears to confuse tax abatements with tax increment financing ("TIF").[7] Second, the citations to Handbook 4420.1 are irrelevant within the context of the MAP Guide. Third, the OIG ignores that even under the guidance it cites that HUD may grant waivers in order to use abatements that do not run with land to increase a mortgage amount. Finally, HUD reviewed and approved the use of the TIF to increase the mortgage amount and has done so on other loans.

Comment 14

1. The OIG has confused tax abatements with TIFs

The OIG is citing to MAP Guide sections relating to tax abatements to conclude that estimated TIF payments should not have been used to increase the mortgage amount of a HUD loan.[8] A TIF is not a tax abatement. A TIF is actually an extra tax assessment that is used to finance the construction of infrastructure on a site. Accordingly, the tax abatement provisions of the MAP Guide simply do not apply.

2. Section 2-2 of Handbook 4420.1 is not related to TIFs nor is it part of the MAP program standards

The Handbook cited by the OIG relates to tax exempt financing of properties and the consideration of tax abatements in a pre-application of a traditionally processed loan. The TIF was not a tax abatement or exemption. As noted above, it was an additional tax assessment.[9] Moreover, the Handbook cited was originally drafted in the 1970s for traditional HUD loan processing. The Map Guide was drafted to apply to loans like Temtor. As noted in section 1.5 of the MAP Guide:

---

[7] The Project had a tax abatement in addition to a TIF. There is no suggestion in the Draft Report that the mortgage increase based on the tax abatement was improperly calculated.

[8] BCM acknowledges that the calculation of additional mortgage based on TIF payments is similar to the calculation of additional mortgage based on a tax abatement in that the amount of the TIF payment or abatement is used to reduce project costs

[9] The OIG also seems to misunderstand that a TIF is secured to real estate. The real estate subject to the TIF will continue to be assessed for TIF payments for as long as the TIF is effect no matter who owns such real estate.

Ref to OIG Evaluation	Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 14

> HUD's Handbooks, Notices, and Forms remain in effect. They will be used for traditional HUD processing of mortgage loan applications. For applications under MAP, the MAP Guide incorporates the majority of Handbook, Notice, and Form requirements. It includes in the Appendix the forms that are required for the customary applications. Certain forms and requirements which are infrequently used, or are too detailed for inclusion in this Guide, are incorporated by reference to the Handbooks, Notices, Forms, statutes or regulations. If there is a conflict between the MAP Guide and the Handbooks, the MAP Guide will take precedence. Questions on conflicts should be raised to the HUD office processing the Lender's application. Where the MAP Guide is silent on a matter, old requirements are obsolete. Rather consult with HUD Headquarters.

Comment 15

The MAP Guide is silent on the issue of TIFs. HUD specifically approved the use of TIF funds in the Temtor matter in the processing of the Loan (as HUD has done in many other loans). Accordingly, BCM complied with MAP Guide requirements.

3. HUD has the authority to grant waivers

Even if the provisions cited by the OIG related to tax abatements are somehow considered analogous to TIFs, the OIG has ignored specific HUD guidance that permits HUD to waive the requirements that a tax abatement run with the land. HUD FAQ no. 5 dated 5/22/03 provides that in certain conditions, the requirement that a tax abatement run with the land can be waived by HUD. That fact demonstrates, that even if an abatement could be considered analogous to a TIF, that the rule is not absolute since it can be waived in certain circumstances.

4. HUD reviewed and approved the use of the TIF payments to increase the mortgage amount.

The OIG's analysis fails to consider the fact that HUD reviewed and approved the use of the TIF payments to increase the mortgage amount and that HUD's actions are consistent with HUD action on other loans. BCM is aware that the same HUD office that approved the Temtor loan has approved the consideration of TIF payments to increase the mortgage amount of at least one other loan and that the New York HUD office has issued at least one similar approval. Accordingly, the OIG's conclusion related to the TIF payments is unsupported and inappropriate.

C. The proposed management agent met the requirements of the MAP Guide.

Comment 16

The OIG contends that the Lender should not have approved the management agent because it "had no HUD experience." The MAP Guide does not require previous HUD experience. If it did, no new management agent could ever be approved. Chapter 10 of the MAP Guide requires an analysis of whether a management agent can bill, control expenses, manage vacancy rates,

Ref to OIG Evaluation

Auditee Comments

Ronald J. Hosking
July 6, 2015
Page 15

collect rents and generally manage a property. There is no indication that the proposed management agent did not meet those qualifications. In fact, pursuant to chapter 10.7(D) of the MAP Guide, HUD makes the final determination of the proposed Management Agent at Firm Submission. HUD accepted the proposed Management Agent. Accordingly, the OIG's contention is without merit.

D. The Lender's controls were both appropriate and sufficient

The Draft Report erroneously concludes that several of the issues already addressed above demonstrate a lack of controls. The OIG is wrong.

First, as already set forth above, the Novogradac Report considered the Lender's controls. In its report, Novogradac concluded that the Quality Control Plan complied with the MAP Guide.

Comment 17

Second, the OIG's contention that the Lender's appraisal review was inadequate is wrong. As already addressed above, CFI reviewed the draft appraisal and provided nine pages of comments to the appraiser reflecting CFI's opinions related to the draft. The appraiser reviewed those comments and made the changes he deemed appropriate in the exercise of his professional judgment. HUD ultimately reviewed and approved that final appraisal.

Third, the OIG's suggestion that the Lender's Quality Control Plan is required to address TIF payments is unsupported. TIF payments are not addressed in the MAP Guide. They are not addressed in any Handbook. No requirement exists that they be addressed in a Quality Control Plan.[10]

Fourth, the OIG's suggestion that the review of the management agent was insufficient is wrong. As noted above, the Lender conducted a review of the management agent pursuant to chapter 10 of the MAP Guide. HUD approved the management agent and, validated CFI's review.

E. Insufficient Cash Flow

Comment 18

The section of the Draft Report entitled "insufficient cash flow" further demonstrates that the Temtor default was related to borrower actions and not due to the underwriting of the loan. The OIG notes that within 10 months, the borrower's delinquencies totaled over $750,000. According to the OIG's own analysis, as set forth in Audit Report 2013-KC-1003, however, the borrower inappropriately diverted over $700,000 from the Project to other uses that benefited the

[10] Even if such a requirement existed, the OIG does not explain what should be covered or how the failure to cover those unidentified issues led to any default.

Ref to OIG Evaluation | **Auditee Comments**

Ronald J. Hosking
July 6, 2015
Page 16

Project owners. In addition, the construction of the Project was delayed by 6 months which obviously affected the lease up of the property.

The OIG also contends that the borrower rented space to a business it owned at rents that were significantly below market. That issue of potential fraud cannot be attributed to the underwriting of the loan. In short, the very issues cited by the OIG demonstrate that factors other than underwriting led to the Loan default.

III. CONCLUSION

Comment 19

Every loan entails some risk of default. The purpose of the MAP Guide is to outline the level of risk that HUD is willing to assume and to provide guidance for a lender to gather, analyze and supply relevant information to HUD. The lender submits the firm commitment application, including a full underwriting package, to HUD to determine whether the loan is an acceptable risk. If HUD determines that the project meets program requirements, it issues a firm commitment to the lender for mortgage insurance.

HUD, in this case, reviewed all the information provided and concluded that the information complied with all program requirements. HUD also concluded that the risk was acceptable and issued a firm commitment. Those judgments, exercised, at the time the Loan was underwritten, demonstrate that CFI complied with its obligations.

In addition, Novogradac concluded in its default review of the Project that the Lender had complied with its underwriting obligations under the MAP Guide.

Finally, as noted above, the loan was underwritten by CFI and submitted to HUD. HUD issued a firm commitment. Thereafter the loan was transferred to BCM in the CFI bankruptcy case. BCM should not and cannot be held responsible for any underwriting errors made by CFI.

Unfortunately, the OIG has failed to consider the appropriate sections of the Map Guide and the previous LQMD review of the Loan. Instead, the OIG has issued a report that, with the benefit of 20/20 hindsight several years later, second-guesses the reasoned opinions of qualified third-party appraisers, that ignores the approval of those reports and opinions by HUD, that seeks to place obligations on BCM that do not exist in the MAP Guide, and that ignores the very terms of the MAP Guide. The OIG's Draft report is fatally flawed and should be withdrawn.

Sincerely,

Constantinos G. Panagopoulos

OIG Evaluation of Auditee Comments

Comment 1 Berkadia stated the report failed to consider the appropriate sections of the MAP Guide, failed to acknowledge HUD's significant role in underwriting and approving the loan, ignored the conclusions of a loan default review, and did not analyze significant events that occurred that were not foreseen.

We reviewed Berkadia's underwriting of the Temtor loan using the responsibilities of the underwriter as stated in the MAP Guide. Berkadia's comments included extensive criteria for HUD's responsibilities in the underwriting process. Berkadia implies HUD's review of the underwriting documents relieves Berkadia of responsibility. Berkadia attempts to support this position by restating sections of the MAP Guide. However, HUD's role in approving the loan is not relevant to whether Berkadia fulfilled its responsibilities. We reviewed HUD's loan default review. The conclusions of the third party reviewer supported our findings. We have included the conclusions in our comments. In its response, Berkadia attempts to portray the default of the Temtor mortgage as a routine event caused by circumstances that could not have been anticipated and adds post hoc analysis. As noted by Berkadia, we only considered information that was available to Berkadia when the loan was underwritten. That information did not support the maximum insurable mortgage amount determined by Berkadia.

Comment 2 Berkadia stated that our discussion draft of the audit failed to distinguish between the actions of Capmark and Berkadia and that during the exit conference we agreed to correct the report to distinguish between the two entities.

We evaluated this request and believe the explanation of the transition is sufficiently covered in the Background and Objectives section of this report. We interviewed three employees that worked for Capmark and Berkadia and asked them to describe any changes noted in the transition from Capmark to Berkadia. They told us the procedures and players remained the same. They said changes were made in upper management and investors. Berkadia signed an assignment of firm commitment for the loan dated January 6, 2010. In the assignment, Capmark transferred all of its right, title and interest in the firm commitment to Berkadia. Berkadia consented to the assignment and agreed to be bound by the terms and conditions of the firm commitment.

Comment 3 Berkadia stated that we had ignored the requirements of the MAP Guide and improperly substituted our own post hoc judgment as to how the Temtor loan should have been underwritten. Specifically, Berkadia stated we failed to acknowledge HUD's significant role in underwriting a loan under the MAP Guide and we failed to consider the appropriate provisions of the MAP Guide in our review.

We reviewed the underwriting of the Temtor loan to determine compliance with the MAP Guide. Berkadia had specific responsibilities that it did not fulfill, such as conducting a sufficient review of all third party reports, determining the loan was economically sound, and determining the loan complied with all FHA statutory, regulatory, and administrative requirements. Although HUD approved the loan, Berkadia was responsible for reviewing the documents to ensure compliance with the requirements and that the loan was economically sound, which it did not. The MAP Guide (Paragraph 15.1.A) stated, "By permitting a MAP Lender to prepare much of the documentation for a loan submission, HUD places confidence in the Lender's integrity and competence." HUD relied on the documents presented by Berkadia. The duties of the lender as written in the MAP Guide are not reduced or eliminated based on duties assigned to other parties. Our audit objective was to determine whether Berkadia properly underwrote the items that established the maximum mortgage amount for the Temtor project. The report cites all related requirements to support the findings in the criteria section of the report, see Appendix C.

Comment 4 Berkadia states the qualifications of the Lender's underwriter from the MAP Guide and restates the duties of the underwriter already included in the report. Berkadia then rewrites the requirements of section 11.1C of the MAP Guide, removing important duties assigned to lender's underwriter, creating a new term the "general review."

The responsibilities of the underwriter are clearly written in section 11.1C of the MAP Guide. We conducted the review of the underwriting of the Temtor loan using the requirements as written in the MAP Guide.

Comment 5 Berkadia's comments included extensive criteria for HUD's responsibilities in the underwriting process. Berkadia stated section 11.2B sheds additional light on HUD's role in the process.

Berkadia left out two very important paragraphs from the citation when presenting its case. These paragraphs limit the responsibility of the HUD review appraiser. The MAP Guide states, "The HUD review appraisers' signature on the Master HUD 92264 and the 92273 and 92274 should not be construed as the reviewers' acceptance of full responsibility for all elements of the report." The full citation of Section 11.2B of the MAP Guide has been added to the Criteria section of this report, see Appendix C. As stated in comment 3, the duties of the lender as written in the MAP Guide are not reduced or eliminated based on duties assigned to other parties.

Comment 6 Berkadia adds two more pages of comments from the MAP Guide citing HUD's responsibilities in the underwriting process.

As stated in comment 3, the duties of the lender as written in the MAP Guide are not reduced or eliminated based on duties assigned to other parties.

Comment 7 Berkadia stated both Capmark and HUD satisfied their respective requirements under the MAP Guide. Berkadia extensively quoted HUD's responsibilities from the MAP guide as evidence that Capmark and HUD fulfilled their responsibilities.

Berkadia does not provide documentation to support the statement that the requirements of the MAP Guide were satisfied. Citing requirements does not provide evidence that they were met. As stated in this report, Berkadia did not properly underwrite the items that established the maximum mortgage amount for the Temtor project.

Comment 8 Berkadia stated HUD certified the accuracy and appropriateness of the judgments that we cited as evidence that Capmark did not properly underwrite the loan. However, Berkadia has the responsibility to conduct a review of all in-house and third party forms/reports/reviews. The duties of the lender as written in the MAP Guide are not reduced or eliminated based on duties assigned to other parties. The MAP Guide states, "The HUD review appraisers' signature on the Master HUD 92264 and the 92273 and 92274 should not be construed as the reviewers' acceptance of full responsibility for all elements of the report." See comment 3 above.

Comment 9 Berkadia stated Novogradac, an independent reviewer, concluded that the lender complied with MAP Guide requirements in underwriting the loan.

We reviewed the Novogradac report to Berkadia dated February 7, 2013. The report conclusion included three issues. First, actual rent being lower than underwritten commercial rents coupled with the increased amount of debt allowed on the property were the main contributors to the early default of the loan. Second, and to a lesser extent, the delays in lease up at the Coca Cola Syrup Plant caused by the water problems also contributed to the early default. Finally, the overall lack of detail and support within the appraisal may have also indirectly contributed to the early default. Novogradac identified several inconsistencies, which may have influenced the underwriting of the transaction. Novogradac stated if the information had been better supported and thorough, it may have led to a different underwriting conclusion.

It should also be noted that the review conducted by Novogradac was a document review conducted in their office. In contrast, our audit reviewed these documents, and we interviewed current and former Berkadia employees, HUD employees, City of St. Louis employees, and the project appraiser.

Comment 10 Berkadia stated that contrary to our assertion, the lender is not responsible for the third-party expert's conclusions.

We did not find any support for this statement in the report written by HUD's Lender Qualification and Monitoring Division. In fact in the report, HUD concluded the following were processing oversights and major contributory factors to the property's early failure: The application was processed with overly optimistic appraisal and underwriting assumptions. The assumptions used in underwriting were submitted with unattainable residential rents, considerably overestimated commercial income, underestimated residential vacancy and total expenses were twice that estimated by the appraiser. In response, HUD required Berkadia to submit a plan of action to ensure MAP underwriting assesses the noted deficiencies of better evaluating market need in urban locations, net operating income potential, and loan sizing due diligence. In addition, Berkadia proposed to better explore and confirm actual going commercial rents in the local market because of "lessons learned." Clearly, HUD and Berkadia recognized the responsibility of Berkadia in underwriting the Temtor loan.

Comment 11 Berkadia stated we failed to consider whether factors other than underwriting caused default of the loan including borrower diversion of funds, construction delays, and the economy. In so doing, Berkadia has added post hoc analysis to this report.

Our audit objective was to determine whether Berkadia properly underwrote the items that established the maximum mortgage amount for the Temtor project. All loans involve risks, including construction delays, and economic risks that the lender is required to document in the underwriting narrative and mitigate as required in MAP Guide, Revised 2002, paragraph 11-1(B). While as noted by Berkadia, we have audited the diversion of funds, this information would not have been available when the loan was underwritten and is not within the scope of our audit.

Comment 12 Berkadia incorrectly stated that we concluded the lender was required to look behind, second-guess or edit the appraisal report.

Berkadia stated a conclusion that is not included in our report. We stated in the report that the MAP Guide required the lender to use due diligence in reviewing third-party reports. If Berkadia had required an investigation of the issues raised by its appraiser during the review of the Coca-Cola syrup plant appraisal, it would have learned that four of the five comparable commercial properties used in the appraisal were owned by Temtor principals, and two of the properties were leased to businesses organized by the management agent of the Temtor. In addition, an investigation would have revealed that one of the leases that the appraisal stated had no concessions, in fact, included several material concessions. The concessions include more than $2.4 million in tenant improvements, guaranteed tax abatement, and a 39 percent reduction in the rent upon lease renewal. This is particularly important because the property was also used in the appraisal to establish the market absorption rate. This then calls into question why the Temtor management agent would rent property to his own businesses at a higher rate. Therefore, the appraisal did not reliably establish a market rate for the commercial property.

Comment 13 Berkadia stated they could not find any record of the specific discussion between Capmark's appraisal reviewer and the appraiser and thus cannot comment on the reasons that the appraiser chose to make some suggested changes and not others.

As stated in the report, Berkadia's procedures did not require that the questions and comments raised by the loan reviewers be resolved. In fact, Berkadia did not provide any documentation that the concerns noted by their in house appraiser, whether the leases were arm's length transactions and what type of tenant improvements were included, were presented to the appraiser.

Comment 14 Berkadia stated we have confused tax abatements with TIFs.

We explained the differences between tax abatement and TIF in the draft report. However, we agree this is confusing so we removed the references to the handbook and tax abatements. Our position remains the same that the payments were not certain and should not have been used in calculating the maximum mortgage amount.

Comment 15 Berkadia stated HUD has the authority to grant waivers, and HUD reviewed and approved the use of the TIF payments to increase the mortgage amount.

Berkadia did not provide any documentation to support that a waiver was requested or granted by HUD to allow TIF payments to increase the mortgage amount of the Temtor project.

Comment 16 Berkadia stated the management agent met the requirements of the MAP Guide. Berkadia stated the MAP Guide does not require previous HUD experience. If it did, no new management agent could ever be approved.

We said in the report Berkadia approved a borrower management team that had no HUD experience to manage this complex project. The MAP Guide required the lender's underwriter to evaluate the resume of the principals and require the addition of members to the development team, if necessary, to satisfy experience requirements.

Berkadia stated Chapter 10 of the MAP Guide requires an analysis of whether a management agent can bill, control expenses, manage vacancy rates, collect rents and generally manage a property. There is no indication that the proposed management agent did not meet those qualifications.

As we said in the report, Berkadia's procedures did not test the competence of the project management team. Its review process did not establish management's ability to control project costs. The review was not adequate as evidenced by the fact that the management agent had no written procedures for administering project funds. Berkadia did not provide any documentation that the analysis of the management agent was completed.

Comment 17 Berkadia stated that our contention that the lender's appraisal review was inadequate is wrong.

As already addressed above, Capmark reviewed the draft appraisal and provided nine pages of comments to the appraiser reflecting Capmark's opinions related to the draft. The in-house review appraiser did raise significant concerns about the commercial space, whether the leases were arm’s length transactions, and what type of tenant improvements were included. Berkadia did not provide any documentation showing how the concerns were resolved or even if they were presented to the third party appraiser.

Berkadia stated our suggestion that the Lender's Quality Control Plan is required to address TIF payments is unsupported.

We did not say it was a requirement of the Lender’s Quality Control Plan. However, as stated in the report, the TIF payments that were not eligible to increase the mortgage payments were used to increase the mortgage by more than $2.9 million. We recommended requiring Berkadia to modify policies and procedures to ensure that future loans represent an acceptable risk to HUD. This should include written procedures to value TIF and tax abatement.

Berkadia stated our suggestion that the review of the management agent was insufficient is wrong.

As noted earlier Berkadia did not provide any documentation that the analysis of the management agent as required by the MAP Guide was completed.

Comment 18 Berkadia claimed the section entitled "insufficient cash flow" further demonstrates that the Temtor default was related to borrower actions and not due to the underwriting of the loan.

We limited our audit to information that was available at the time of the underwriting of the loan in assessing the performance of Berkadia.

Comment 19 In conclusion, Berkadia stated every loan entails some risk of default. The purpose of the MAP Guide is to outline the level of risk that HUD is willing to assume and to provide guidance for a lender to gather, analyze and supply relevant information to HUD.

HUD requested we review the underwriting of the loan due to the rapid default. Such rapid defaults and claims of HUD insured multifamily projects are rare in the current environment. A search of multifamily properties endorsed since January 1, 2010 revealed only eleven loans that had been assigned to HUD, three of which were held by Berkadia. Berkadia attempts to portray the default of the Temtor mortgage as a routine event caused by circumstances that could not have been anticipated.

Berkadia stated we had failed to consider the appropriate sections of the MAP Guide and the previous Lender Qualification and Monitoring Division (LQMD) review of the loan.

As noted in the Scope and Methodology of this report we reviewed relevant regulations and the findings of HUD's LQMD. We communicated several times during our audit with the former head of LQMD.

Berkadia stated that they should not and cannot be held responsible for any underwriting errors made by Capmark.

However, Berkadia consented to the assignment of the firm commitment and agreed to be bound by the terms and conditions. Berkadia then became responsible for ensuring those conditions were met by or before closing.

Berkadia stated the report is fatally flawed and should be withdrawn. As stated in the comments above, Berkadia claims that the report is flawed are not correct. Berkadia did not properly determine the maximum mortgage amount for the Temtor loan, resulting in an $11.3 million loss to HUD.

Appendix C

Criteria

Excerpts from the MAP Guide, revised March 15, 2002

3.7 SECTION 220

C. Maximum mortgage limitations. In general, the HUD maximum insurable mortgage is limited to the lesser of:

1. 90% of HUD estimated replacement cost (new construction) and 90% of the sum of the HUD estimated cost of repairs and rehabilitation and the as is value of the property (substantial rehabilitation).
2. A mortgage amount supported by 1.1 debt service coverage (90% of net income).
3. Statutory per unit limits, adjusted by the Field Office high cost percentage. (See Chapter 8 for complete details.)

7.2 SELECTION OF APPRAISERS AND MARKET ANALYSTS

The MAP Lender is responsible for the selection, approval, and training (if needed) of appraisers and market analysts who are familiar with HUD reviews and guidelines. Lenders must ensure that each appraiser and market analyst selected is qualified to appraise or perform market analyses for multifamily properties by reviewing their education, quality, and frequency of multifamily experience, sample appraisals and market studies, professional affiliations, and state licenses or certifications.

7.4 APPRAISAL REQUIREMENTS

A. Each appraisal must meet the following requirements:

1. Be prepared for the Lender and paid for and initiated by the Lender.
2. For value-based programs, Section 223(f), Section 232 and Section 232/223(f), each appraisal shall be a complete appraisal in accordance with all applicable requirements contained in USPAP [Uniform Standards of Professional Appraisal Practice] Standards Rule 1 and in compliance with this guidebook. For sections 220 and 221, the appraiser may prepare a limited appraisal as outlined in paragraph 7.4 A 4 below. The appraiser should reference the Jurisdictional Exception Rule where appropriate. The Departure Rule is not authorized. The appraisal report format must meet the specifications of Standards Rule 2-2a and be a Self-Contained Report. Form HUD-92264 (92264-HCF [health care facility] for Section 232 projects) and supporting forms, i.e., HUD-92264-A, HUD-92273 and HUD-92274 must be completed by the appraiser. The self-contained report will be supportive of and consistent with the conclusions made on the forms
3. Adequately describe the geographic area, neighborhood, rental competition, sales comparables, site, and improvements.
4. Produce a fair market value supported by the reconciliation of the cost, income, and direct sales comparison approaches to value for Section 207/223(f), 232, and

232/223(f). The cost or summation approach must consider all applicable forms of depreciation for 223(f) and 232/223(f) cases. For this reason, the replacement cost approach shall not automatically set the upper limit of value for these programs. For New Construction and Substantial Rehabilitation pursuant to Section 232, the replacement cost or summation approach shall in all cases set the upper limit of value in the reconciliation process. This policy is not intended to negate the necessity of the final reconciliation of the three approaches. Section 232 remains a value-based program. It is rather an acknowledgment of the basic principle of substitution in that no prudent purchaser would pay more for a property than the cost to acquire a similar site and construct improvements of equal desirability and utility. A Limited appraisal using the Replacement Cost for projects insured through Sections 221(d) and 220 should be supported by the cost approach to value. Support “As Is” value in Substantial Rehabilitation by use of the income and direct sales comparison approaches to value.

5. Have an effective date within 120 days before the date the Firm Commitment application or pre-application package is delivered by the Lender to HUD. Updated appraisals can be submitted with the appraiser re-inspecting the subject property, re-surveying the rental comparables, and reviewing the market for any additional sales comparables.
6. Be prepared with the list of information supplied by the MAP Lender contained in Appendix 4.
7. Include appraiser’s certification. See certification format in Chapter 11 of MAP Guide.
8. Under MAP the USPAP Departure Rule is not authorized. Instead, the appraiser shall invoke the USPAP Jurisdictional Exception Rule to fulfill MAP underwriting requirements. By definition, the Jurisdictional Exception Rule renders a specific portion of USPAP void and of no force or effect; therefore, for the purposes of that assignment, the excepted portion of USPAP does not exist and so cannot be subject to the Departure Rule. Pre-application valuation exhibits should be viewed as an Appraisal Consulting Assignment as defined in USPAP Standard 4, and are prepared as a precursor to the final report submitted at the firm commitment phase. For Section 223(f), Section 232 and Section 232/223(f), the appraisals should be a Complete Appraisal in accordance with all applicable requirements contained in USPAP Standards Rule 1, and in compliance with this guidebook. For Sections 220 and 221, the appraiser may prepare a Limited Appraisal as outlined in paragraph 7.4 A 4.
9. The primary appraiser designated by the Lender and approved by HUD must perform the property inspection AND sign the appraisal report and the supporting HUD forms
10. Photos of the subject, comparable sales and comparable rentals are required with all submissions.

7.6 ESTIMATED RENTAL INCOME

A. Rental estimates. First the annual gross income of the subject project is estimated. The processing will include estimates of income from market comparables, rental concessions, and an assessment of the general health of the rental market. The gross income estimate assumes a 100 percent occupancy level and reflects rent levels current as of the appraisal date or date of the market study. Also, the effect that any proposed repairs to the project will have on rents, expenses, and net income must be considered. (Not all repairs increase rents, occupancy, net income, and/or decrease expenses)

B. Rent comparables. Market Rent by Comparison shall be estimated by the Lender's appraiser by completing HUD-92273. Note that use of HUD Form 97723-S8 is not authorized for FHA mortgage application processing. One HUD-92273 form is to be prepared for each type and size (if significantly different) of rental unit in the subject property. The rent comparables and units selected for comparison shall be as similar as possible to the subject property and units as they relate to location, structural type, number of bedrooms, and average unit size. Market rate units from partially assisted projects can be used as rental comparables in the absence of better rental data. Consistent adjustments for significant differences between the comparables and the subject units shall be derived from the market and applied to the subject rent estimate. Rental adjustments are always made to the comparables for differences from the subject project. The Lender's appraiser should select the final rent estimate based on accepted correlation procedures. Generally, the indicated rent estimate will be from the central 60 percent of the rental range of the indicated rents. Just as the most appropriate rent comparable must receive more weight, the general health of the rental market must be recognized before relying upon one or two optimistic indicators. On tax credit and/or bond financed applications the appraiser should also complete the HUD-92264T in determining the appropriate processing rents.

8.1 QUALIFICATIONS AND DUTIES

B. Major Duties and Responsibilities of the Lender's Underwriter

1. The underwriter serves as a member of the Lender's processing team, calling for specific requirements and terms in the preparation of underwriting recommendations to HUD. The duties and responsibilities are divided into two phases. The first phase involves application underwriting and the second phase relates to the construction period.
   a. Duties and responsibilities associated with the application underwriting are as follows:
      (1) Makes a determination of the acceptability of the general contractor, the sponsor, the mortgagor, if formed, and its key principals through a thorough analysis of their credit, character, financial condition, motivation for ownership, availability of assets for closing and adequacy of income for total obligations.
      (2) Uses trade references, bank references, credit data and construction experience resumes in analyzing the construction capability of the general contractor including financial stability, and ability to complete the project.
      (3) Determines the recommended maximum mortgage amount and other key terms of the loan.

8.3 FIRM COMMITMENT PROCESSING – DETERMINING ACCEPTABILITY OF THE BORROWER AND GENERAL CONTRACTOR

A. In General

A key component of the underwriting process is to assess the mortgagor's ability to manage the development, construction, completion, and successful lease-up of the property. The underwriting of multifamily and healthcare projects involves evaluating the character, ability and financial condition of the sponsor, mortgagor, its key principals, and the general contractor. The Lender's underwriter must:

1. Identify the mortgagor and its principal or key individuals.
2. Analyze the credit worthiness of the principal sponsors, the mortgagor entity, if formed, and the contractor.
3. Analyze the mortgagor and contractors experience record.
4. Determine the financial capability of the mortgagor and the general contractor.
5. Evidence specific experience (within the previous 5 years) in underwriting the development and operation/management of health care facilities.

J. Analyzing the Borrower's and Contractor's Previous Experience:

1. The Lender's underwriter is to evaluate the resume of the principal(s). In doing so, the underwriter will be looking for their experience in developing, owning or building similar multifamily properties. Pay particular attention to:
    a. type and size of previous projects;
    b. geographic area of business involvement;
    c. length of time served in this capacity; and
    d. past roles in multifamily business.
2. Each resume should demonstrate the level of experience needed to successfully complete the development of the project.
3. Require the addition of members to the development team if necessary to satisfy experience requirements.

10.1 INTRODUCTION (MANAGEMENT ANALYSIS)

A. Management agents that operate HUD-insured multifamily properties play a key role in providing quality affordable housing. This chapter reflects the policy of property owners, management agents, residents and HUD working together over the long term to meet this objective. MAP Lenders play an important role in the analysis of the proposed management program.

B. While it is the ultimate responsibility of the project owner/mortgagor to select and oversee the management agent of an insured property, the establishment of an effective relationship among HUD, the owner, and the management agent is critical to the success of the development over the life of the mortgage. The relationship is clarified at the Firm Commitment stage, when detailed management documents are submitted with the Firm Commitment application or when there is a change in management.

C. The Lender will review these documents to determine whether the proposed management agent demonstrates the capability and track record to assure that the development will be managed in a prudent, efficient, and cost-effective manner. The required documents help to demonstrate whether or not the agent:

1. Is eligible for approval and in good standing with HUD.
2. Demonstrates effective management experience and acceptable operating procedures.
3. Demonstrates adequate fidelity bond coverage.
4. Is in compliance with civil rights laws, regulations and requirements.
5. Is able to positively communicate and cooperate with legitimate resident associations.

D. If the Lender favorably assesses the above items and HUD approves this assessment, then the owner may execute a Management Agreement with the proposed agent. Since the management agent's contract is with the project owner, it is HUD's policy to not unreasonably withhold approval of the management agent, consistent with the Department's responsibility to protect the public interest.

10.2 EXHIBITS REQUIRED FOR FIRM COMMITMENT

1. HUD 2530 Previous Participation Certification. For all principals and affiliates of the management agent. This form provides comprehensive information about all HUD-related experience by the management agent and is reviewed by the HUD Field Office, and at times by the HUD Washington office. This also applies to lessees.
2. HUD 9832, Management Entity Profile for the Agent. This form provides detailed information regarding the organization, operation, and experience of the proposed management agent. The management plan should provide a narrative overview as support to this exhibit and should include any pertinent leasing or management strategies that are not covered in Form HUD-9832.

10.3 LENDER REVIEW OF MANAGEMENT DOCUMENTS

The Lender will carefully review the deliverables included in the Firm Commitment application package to determine the acceptability of the proposed management agent. The Management Entity Profile is of particular importance in determining the qualifications of the proposed agent.

The Lender must review the qualifications for the proposed agent to assess the agent's ability to manage the project effectively and in compliance with HUD requirements. The Lender must consider each of the factors below in reviewing an agent's qualifications.

A. Past and Current Management

1. The Lender must review the proposed agent's past experience and current performance with respect to the following performance indicators
   a. Billing
   b. Controlling operating expenses
   c. Vacancy rates
   d. Resident turnover
   e. Rent collection and accounts receivable

f. Physical security
g. Physical condition and maintenance
h. Resident relations

11. 1 LENDER UNDERWRITING

B. Firm Commitment application: The MAP Lender's underwriter must review the in-house and third party reports and determine that the processing of the loan is in accordance with the requirements of this guide and that the proposed loan represents an acceptable risk (replacement cost programs) or is economically sound (value programs). The underwriter must document any changes made to the Lender's technical reports. In the package submitted to HUD, the underwriter must provide a narrative analysis describing the mortgage transaction containing a discussion of:

1. Characteristics of the proposed mortgage that make it economically sound or an acceptable risk and the reasons why the Lender recommends the loan for mortgage insurance.
2. Any risk factors.
3. Changes in the project from the preapplication stage including changes in sponsorship, proposed mortgagor development team and Lender reviewers.
4. Evaluation of the financial capacity of the principals of the borrower and its ability to repay the loan.
5. Evaluation of the financial and technical capacity of the general contractor to build/rehabilitate the project.
6. Property's financial analysis (profile and trend) (Section 223(f),232/223(f) only)
7. Property's physical description (Section 223(f), 232/223(f) only).
8. History of borrower's equity investment in the property (Section 223(f), 232/223(f)refinances only).
9. Analysis of market, rents, expenses and estimated rent-up and operating deficit.
10. Adequacy of the proposed Reserve for Replacement (207/223(f) and 232/223(f) only).
11. Documentation of any changes the underwriter made to the appraisal/technical reports with justification.
12. Requests for any waivers of FHA requirements with supporting documentation.
13. Certifications from the individual reviewers. (See 11.2H.)

C. Due diligence. With the Firm Commitment package the MAP Lender certifies that:

1. The Lender has reviewed all in-house and third party forms/reports/reviews.
2. The preparer of the forms/reports/reviews is qualified as required by this guide, and has the insurance, if any required by this guide.
3. The forms/reports/reviews were prepared in the manner required by the guide and the forms/reports reviews are complete and accurate.
4. The proposed loan represents an acceptable risk to the Department (replacement cost programs) or is economically sound (value programs), based upon the Lender's review and analysis and the proposed loan and processing complies with all FHA statutory regulatory and administrative requirements.

11. 2 HUD Field Office Underwriting Review

B. HUD Reviewers Signature and Certifications: Upon determination of acceptability for processing, the HUD reviewers should sign their individual Technical Reviews and when determined acceptable for processing, the Master HUD 92264 prepared by the lender. The Master HUD 92264 is the most critical underwriting document because it is a summarization of key technical processing conclusions which, along with the HUD Form 92264A, are the basis for the FHA Firm Commitment. Since MAP requires a technical review of the lender's underwriting conclusions, the Master HUD Form 92264 is the logical and appropriate form that HUD reviewers should sign or co-sign to authenticate their review as opposed to individual 92264s prepared by third party contractors. HUD appraisal reviewers should also sign the Forms 92273 and 92274 which provide crucial underwriting justifications for the amounts in the 92264. Long before the implementation of MAP, it has been an FHA basic procedure to require the HUD review appraiser's signature on the aforementioned forms.

The Department believes that the continuation of this long standing policy clearly documents the underwriting conclusions and decisions made by HUD staff. This same policy is extended to HUD architecture, and cost, and mortgage credit examiners performing review functions under MAP and their respective forms. HUD review appraiser signatures, on such Forms as the 92264, attest to the quality of the review, that the processing is in compliance with MAP technical instructions, that it is free of errors and has no omissions, and that the appropriate appraisal procedures and analysis have been completed. Additionally, as the MAP Guide currently states, MAP requires a Technical Review of appraisals.

The HUD review appraisers' signature on the Master HUD 92264 and the 92273 and 92274 should not be construed as the reviewers' acceptance of full responsibility for all elements of the report. To avoid any confusion or misunderstanding regarding the HUD review appraiser signing the 92264, 92273 and 92274, the Department invokes the USPAP Jurisdictional Rule. The authority justifying this action should be stated in the review appraisers work product and in Section O, "Remarks and Conclusions", of the HUD Form 92264. As a guide and for the purposes of consistency we suggest that MAP review appraisers use the following language:

"Despite joint signatures of the appraiser and review appraiser on this document, the review appraiser's signature does not constitute the acceptance of full responsibility for the appraisal or the contents of the appraisal report under review. It indicates that the processing has been reviewed in conformance with USPAP Standard 3 and related provisions and found to be acceptable for use in HUD's internal underwriting decision making process".

The HUD's review appraisers' technical review should comply with USPAP Standard 3. To document his review, the review appraiser should complete Appendix 7C.1and the review report must include a signed certification as prescribed by USPAP Standard 3.

K. Certifications.
I understand that my (appraisal, market study or architectural, cost, mortgage credit,

valuation review) will be used by _______ (name of MAP Lender) to document to the U.S. Department of Housing and Urban Development that the MAP Lender's application for FHA multifamily mortgage insurance was prepared and reviewed in accordance with HUD requirements. I certify that my review was in accordance with the HUD requirements applicable on the date of my review and that I have no financial interest or family relationship with the officers, directors, stockholders, or partners of the Borrower, the general contractor, any subcontractors, the buyer or seller of the proposed property or engage in any business that might present a conflict of interest.

I am employed full time by the MAP Lender (underwriter) or under contract for this specific assignment (appraiser, market analyst, cost architect) and that I have no other side deals, agreements, or financial considerations with the MAP Lender or others in connection with this transaction.

__________________ Signature

Warning: Title 18 U.S.C. 1001, provides in part that whoever knowingly and willfully makes or uses a document containing any false, fictitious, or fraudulent statement or entry, in any manner in the jurisdiction of any department or agency of the United States, shall be fined not more than $10,000 or imprisoned for not more than five years or both.

15.1. SANCTIONS OF A MAP LENDER: OVERVIEW

A. By permitting a MAP Lender to prepare much of the documentation for a loan submission for mortgage insurance, HUD places confidence in the Lender's integrity and competence. HUD and MAP Lenders have a mutual interest in ensuring consistent Lender competence and compliance with the MAP Guide and other relevant guidance and handbooks. If in the process of performing this work, the Lender places HUD at risk, HUD needs to issue a Warning Letter or sanction the Lender as quickly as possible.

15.3. BASIS FOR ISSUING A WARNING LETTER OR SANCTIONING A MAP LENDER

A MAP Lender's underwriting and construction loan administration may lead to a Warning Letter or sanction. Examples include, but are not limited to, the following:

B. Serious offenses that might be a basis for a Warning Letter and/or Probation, Suspension, or Termination include:

5. Evidence that a Lender's inadequate or inaccurate underwriting was a cause for assignment of an FHA-insured mortgage and claim for insurance benefits to HUD.

15.17. REFERRAL TO THE MORTGAGEE REVIEW BOARD OR THE INSPECTOR GENERAL.

A. If the Hub/Program Center Director determines that a MAP Lender's actions or failure to act appears to be a compliance matter justifying action by the Mortgagee Review Board, including possible removal of its authority to do business as an FHA Lender, s/he must bring this matter and the administrative record to the attention of the Director, Office of

Multifamily Development in Headquarters. The Director will refer the matter to the Director of the Mortgagee Review Board Division in the Departmental Enforcement Center. See Section 2-4, Requests for Mortgagee Review Board Action, HUD Handbook 4060.2 REV 2, Mortgagee Review Board, and HUD Regulations at 24 CFR 25.

Excerpt from Uniform Standards of Professional Appraisal Practice, 2010-2011 Edition

Market value means the most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

1. buyer and seller are typically motivated;
2. both parties are well informed or well advised and acting in what they consider their own best interests;
3. a reasonable time is allowed for exposure in the open market;
4. payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and
5. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.