



U.S. Department of Agriculture
Office of Inspector General
Western Region
Audit Report

Rural Development
Lender Servicing of
Business and Industry
Guaranteed Loans - State of Arizona
Lender B



Report No.
34601-4-SF
September 2001



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Western Region - Audit

75 Hawthorne Street, Suite 200

San Francisco, CA 94105

TEL: 415-744-2851 FAX: 415-744-2871



DATE: September 12, 2001

REPLY TO

ATTN OF: 34601-4-SF

SUBJECT: Rural Development - Lender Servicing of Business and Industry
Guaranteed Loan – State of Arizona, Lender B

TO: Eddie Browning
State Director
Arizona State Office
Rural Development

This report presents the results of our audit of a Lender's Servicing of a Business and Industry Guaranteed Loan – State of Arizona. Your August 2, 2001, response to the draft report is included as Exhibit C of the report.

To accept management decision for the recommendation, we will need a copy of the correspondence notifying the lender that Rural Development is rescinding the loan note guarantee.

In accordance with Department Regulation 1720-1, please furnish a reply within 60 days describing the corrective action taken or planned and the timeframe for implementation for the recommendation for which management decision has not yet been reached. Please note that regulations require a management decision to be reached on all recommendations within a maximum of six months from report issuance.

We appreciate the cooperation and assistance provided by your staff during our audit.

ls\

SAM W. CURRIE
Regional Inspector General
for Audit

EXECUTIVE SUMMARY

RURAL DEVELOPMENT LENDER SERVICING OF BUSINESS AND INDUSTRY GUARANTEED LOANS – STATE OF ARIZONA LENDER B

AUDIT REPORT NO. 34601-4-SF

RESULTS IN BRIEF

This report presents the results of our audit of a lender's servicing and administration of Business and Industry (B&I) guaranteed loans that were active in fiscal years 1997 through 2001. We performed this review as part of a nationwide review of lender servicing actions. We selected the State of Arizona for review based on the number of guaranteed loans outstanding and the dollar value of those loans. We reviewed the lender servicing of loans we judgmentally selected from an analysis of the borrower loan files and we identified this lender as lender B. The borrower was delinquent on two guaranteed loans totaling \$2.7 million that were used to construct a hotel within an Indian reservation. Rural Development staff also raised concerns about this borrower.

Under the B&I loan program, Rural Development guarantees loans made by private lenders to improve private business and employment in rural communities. The objectives of our audit were to determine if (1) the lender properly serviced B&I guaranteed loans by monitoring collateral and timely submitting required documents to Rural Development; and (2) the loan proceeds were used as specified in the loan agreements. Although, the loans were used to construct the hotel, we found the plans and specifications for the hotel were not followed and the lender did not service the loan properly.

Based on evidence we obtained, we concluded that the hotel constructed with the \$2.7 million in guaranteed loan funds would never be certified as safe for occupancy and in all likelihood would have to be torn down. We concluded that the lender was negligent in servicing the loan.

- The lender did not stop funding construction even though it was aware that the building contractor deviated from the original contract plans and that those deviations seriously compromised the building's entire

structural system. Because of the significance of the deviations, the architect on the project resigned after only 5 months into construction. In a field report to the lender, the structural engineer recommended that “the building not be inhabited until the entire structural system is corrected per contract documents.” We were unable to find evidence that any correction was approved. The architect himself informed the borrower and the lender that the structural deviations from the design were too radical and that he had to “disassociate [himself] from any alternated remedy.” After construction was complete, a contract engineer informed the borrower there was “no way to undo the damage” that was done and recommended that the borrower “raze the existing structure and start over.” Although the hotel currently has about a 44 percent occupancy rate, we concluded from conversations with the architect that the building should be considered unsafe.

- The lender did not contract with a private inspection company to perform critical building inspections after it was determined that neither the county building authority nor the Indian reservation building department would accept jurisdiction over the project. Throughout the project, the lender continued to believe a certificate of occupancy would be issued validating the building, but it never acknowledged the fact that only governmental entities can issue a certificate of occupancy and only after all building inspections have been performed. As a result, neither the lender, borrower, architect, engineer, nor contractor can assure Rural Development that the building is built to plans and specifications and meets all Federal, State, and local building codes. No certificate of occupancy has been or likely to be issued for this building.
- The lender did not require the contractor or subcontractors to provide payment and performance bonds as required by the loan note agreements. Without such bonds, both the lender and Rural Development were placed in a vulnerable position in case of default by the contractors involved. As a result, the lender was unable to receive any compensation from the contractor’s bonding companies after it was determined the contractor had breached its contract.

Our audit results indicate that the lender did not properly service this guaranteed loan and did not obtain and submit required documents to Rural Development. In our opinion, Rural Development should rescind the loan note guarantee issued to the lender. Rural Development should consult with the Office of the General Counsel prior to any actions taken against the loan note guarantee and lender.

KEY RECOMMENDATIONS

In consultation with the Office of the General Counsel, rescind the loan note guarantee to the lender to eliminate any future loss claims by the lender against Rural Development.

AGENCY RESPONSE

In its written response to the draft report, dated August 2, 2001, the Arizona Rural Development concurred with the key recommendation to rescind the loan note guarantee to eliminate any future loss claims by the lender. Rural Development also stated they will discuss with the National Servicing Division the steps to be taken to begin this process

OIG POSITION

To reach management decision for this recommendation we need a copy of the correspondence notifying the lender that Rural Development is rescinding the loan note guarantee.

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
RESULTS IN BRIEF.....	i
KEY RECOMMENDATIONS	iii
AGENCY RESPONSE	iii
OIG POSITION.....	iii
TABLE OF CONTENTS.....	iv
INTRODUCTION.....	1
BACKGROUND	1
OBJECTIVES.....	2
SCOPE	3
METHODOLOGY	3
FINDING AND RECOMMENDATION.....	5
CHAPTER 1	5
NEGLIGENT SERVICING BY THE LENDER RESULTED IN STRUCTURALLY FLAWED BUILDING.....	5
FINDING NO. 1	5
RECOMMENDATION NO. 1	17
EXHIBIT A – SUMMARY OF MONETARY RESULTS	18
EXHIBIT B – ENGINEER REPORT DATED SEPTEMBER 14, 1998	19
EXHIBIT C – AUDITEE RESPONSE TO DRAFT REPORT	29

INTRODUCTION

BACKGROUND

The Rural Business-Cooperative Service, an agency within the U. S. Department of Agriculture (USDA) Rural Development mission area, operates loan programs that are intended to assist in the business development of the Nation's rural areas and the employment of rural residents. To achieve this mission, the agency guarantees B&I loans made by a private lender. A private lender provides the loan to the borrower as long as Rural Development guarantees a partial repayment of such loans. The private lender has the primary responsibility for loan servicing and protecting the collateral while the Rural Development is responsible for ensuring that loan servicing is properly accomplished by the lender.

The Government's guarantee authority is not intended to be used for marginal or substandard loans or for the relief of lenders having such loans. These loans are made primarily to finance sound business projects that create or retain jobs in rural areas.

Guarantees are provided on loans made by traditional lenders, such as commercial banks, and to a lesser extent, on loans made by entities using investment capital for lending. Rural Development provides the following guarantees: 80 percent on loans of \$5 million or less, 70 percent on loans between \$5 million and \$10 million, and 60 percent on loans more than \$10 million.

Regulations provide that lenders are responsible for servicing the entire loan and for taking all servicing actions that a prudent lender would perform in servicing its own portfolio of loans that are not guaranteed. Lenders are responsible for notifying Rural Development officials of any violations of lenders' loan agreements. The guarantee is unenforceable by the lender to the extent any loss is occasioned by violation of usury laws, use of loan funds for unauthorized purposes, negligent servicing, or failure to obtain the required security interest regardless of the time at which the Agency acquires knowledge of these actions.

This responsibility of the lender includes, but is not limited to, the collecting of payments, obtaining compliance with the covenants and provisions in the loan agreement, obtaining and analyzing financial statements, checking on payment of taxes and insurance premiums, and maintaining liens on collateral. All lenders obtaining a B&I loan guarantee

are responsible for obtaining valid evidence of debt and collateral in accordance with sound lending practices.

Our review of the borrower's case file determined the original appraisal, dated March 7, 1997, estimated the value of the proposed building, a hotel, at \$3.2 million. The lender requested another appraisal to be performed, prior to loan liquidation, to meet the specific requirements of Rural Development instructions. The value of this appraisal, dated June 15, 1999, was \$2.66 million, for the hotel "as is," and a liquidation value of \$2.13 million. Construction deviations, architectural and engineering inspections, and the location of the hotel were documented as reasons for the reduction in the value.

The lender later requested and received an updated appraisal, dated October 5, 2000, and forwarded this appraisal to Rural Development. This appraisal valued the hotel at \$1.69 million.

In the latest appraisal, the appraiser noted the marketable title of this property was in question due to the location of the hotel within the Indian reservation boundaries. The appraisal also made the following assumptions about the hotel:

- The hotel is in full compliance with all applicable Federal, State, and local regulations; and
- All required licenses, consents or other legislative or administrative authority from any local, State, or national government have been obtained.

In addition, the appraiser noted all inspections of the hotel were casual and that the structures were not checked for building code violations. The appraiser remarked that appraisal values generally assume that all buildings meet applicable building codes, unless so stated in the report.

OBJECTIVES

Our objectives were to determine if: (1) the lender properly serviced B&I guaranteed loans by monitoring collateral and submitting required documents to Rural Development timely, and (2) the loan proceeds were used as specified in the loan agreements.

SCOPE

We reviewed B&I loan note guarantees issued by the Rural Development Arizona State office during fiscal years 1996 through 1999. We selected the State of Arizona for review based on the number of guaranteed loans outstanding and the dollar value of those loans. As of November 1, 2000, the Rural Development Arizona State office had issued 42 loan note guarantees to 33 different borrowers involving 9 lending institutions. The State office has issued guarantees on loans totaling over \$57 million.

The audit control point (ACP) judgmentally selected for review 7 of 33 borrowers who received loan note guarantees. This borrower was selected because he was delinquent on two guaranteed loans totaling \$2.7 million, and because the Rural Development staff voiced concerns about him. Rural Development guaranteed 90 percent¹ of a \$2,050,000 loan to the borrower, closed on August 13, 1997, and 80 percent of a \$650,000 loan, closed on August 24, 1998. Rural Development's total guaranteed amount for this borrower was \$2,365,000. Our scope covered servicing actions from fiscal years 1997 through 2001 for the aforementioned loans. We elected to review the servicing actions of two lenders in Arizona. We reviewed the lender servicing of the loans we judgmentally selected from an analysis of the borrower loan files and we identified this lender as lender B. The review of the second lender will be reported under audit number 34601-2-SF. We performed our audit fieldwork from November 2000 through March 2001.

The audit was conducted in accordance with generally accepted government auditing standards.

METHODOLOGY

To accomplish the overall objectives of the audit, we performed the following procedures:

At the Rural Development Arizona State office, we (1) interviewed State office personnel to understand the loan note guarantee program, (2) reviewed and obtained borrower case files, and (3) selected the lenders and borrowers to be reviewed for this audit.

At the lender's offices, we interviewed lender personnel to determine their understanding of the loan program and their responsibilities for servicing, and we reviewed the borrower's files to ensure compliance with guarantee

¹ A guarantee of up to 90 percent can be provided on a loan of \$10 million or less if Rural Development's administrator approves the higher percentage.

conditions.

We visited the site and interviewed the borrower to verify the existence of collateral pledged to secure the loan and to determine if the borrower had any concerns regarding the servicing of the loan.

We interviewed the architect of record, the lender's construction control agent, and county building authority staff to obtain and determine specific information relating to the construction of the project.

FINDING AND RECOMMENDATION

CHAPTER 1	NEGLIGENT SERVICING BY THE LENDER RESULTED IN STRUCTURALLY FLAWED BUILDING
------------------	---

FINDING NO. 1

The lender did not service the loan in accordance with the conditions set forth in the loan agreements. Specifically, the lender did not ensure that (a) the contractor built the structure in accordance with the approved plans, (b) the required building inspections were completed, and (c) the contractor obtained the required payment and performance bonds. Lender representatives made assumptions about the extent of oversight that was being provided over the construction of the building and were not aware of certain requirements of the loan. The resulting building was considered structurally unsafe by the original architect and structural engineer.

Regulations² state:

*The lender is responsible for servicing the entire loan and for taking all servicing actions that a prudent lender would perform in servicing its own portfolio of loans that are not guaranteed. The loan note guarantee is unenforceable by the lender to the extent any loss is occasioned by violation of usury laws, use of loan funds for unauthorized purposes, **negligent servicing**, or failure to obtain the required security interest regardless of the time at which the Agency acquires knowledge of the foregoing. [emphasis added]*

In February 1996, the borrower contracted with an architect to design and plan a 2-story, 75-unit hotel to be located on fee simple land³ within an Indian reservation. The 4.5-acre plot of land was titled in the county assessor's office and was designated for the construction of the project. In April 1996, a feasibility study was conducted and the value of the project was estimated at about \$3.14 million. The project was considered

² 7 CFR Chapter XLII (1-1-98 Edition), Subpart B, 4287.107 – Routine Servicing.

³ The borrower had title (privately-owned) to the 4.5-acre parcel of land within the reservation boundaries.

needed and economically feasible for the area. In March 1997, a proposed project appraisal was provided to the lender establishing the value of the project at \$3.2 million.

The lender contacted Rural Development to determine if guaranteed monies were available to ensure that the loan could be made. A Rural Development loan note guarantee would guarantee payment of a certain percentage of the entire loan in case the borrower defaulted. Rural Development approved a loan note guarantee for this project subject to the terms set forth in the lender's construction loan agreement, and Rural Development's loan note guarantee and conditional commitment.

Deviations from construction plans resulted in a structurally compromised building

Engineering reports and documents that we obtained disclosed that the contractor deviated from the approved architectural plans and that these deviations structurally compromised the building. The structural engineer stated that the building should not be occupied until the construction flaws were corrected. The architect deemed the building to be unsafe and stated that the building had severe construction flaws that would jeopardize the longevity of the structure. Because the hotel continues to be occupied, the Government may be at risk for any future liabilities assessed.

We determined the lender did not approve the construction changes and did not ensure that any contractor deviations from the approved plans and specifications were remedied prior to further construction. The lender relied on the borrower and the borrower's architect to ensure that the building was constructed in accordance with the approved plans.

Regulations⁴ state that

the loan note guarantee will not be issued until the lender certifies to the following:...all development has been or will be substantially completed in accordance with plans and specifications [and] conforms with applicable federal, state, and local codes.; [and] all other requirements of the conditional commitment have been met.

The lender's construction loan note agreement⁵ requires that (1) the lender initial off on any additions or changes made by the contractor to the

⁴ 7 CFR Chapter XLII (1-1-98 Edition), 4279.181 (a-o)

⁵ The Construction Loan Agreement between the lender and borrower dated August 13, 1997, sets forth conditions of

plans and specifications approved by the architect, (2) all work be completed in compliance with plans and specification, and (3) the contractor promptly correct any defect in the improvements, or any departure from the plans and specifications not approved by the lender.

On August 15, 1997, the contractor was given notice by the borrower to proceed with the construction of the project. The architect's agreement with the borrower was to spot-check the work of the contractor to ensure that the work was being completed in accordance with the architect's plans and specifications.

During the second field inspection, completed on October 21, 1997, the architect observed framing deviations⁶ from the original plans. The architect questioned the contractor about the modification. The contractor responded that he "spoke to the engineer and it was approved." On October 23, 1997, the architect questioned the structural engineer whether this change had been approved. The engineer stated he was not informed of the change and requested the building truss⁷ calculations from the architect to ensure the structural integrity of the building.

On November 5, 1997, the architect asked the contractor for the current layout of the trusses to compare their current position with their location on the original plans and specifications. We determined the contractor never sent a legible copy of the truss plans and calculations to the engineer until the architect requested them to do so on December 2, 1997. A November 21, 1997, field inspection report, prepared by the architect and submitted to the lender, disclosed that the "floor framing [was] not installed per structural plans."

On December 9, 1997, the architect made another visit to the construction site with the structural engineer and made the following observation:

Building structural system has not been installed per plans. Structural engineer has serious concerns regarding structural integrity... Construction is not in conformance with contract documents provided by structural engineer.

The structural engineer believed the deviations were severe enough to forward a field report to the lender describing the conditions noted at the site. The field alert identified 14 separate instances in which the contractor

the loan that the borrower and lender are to follow. The conditions in this agreement and all other related documents were to be adhered to.

⁶ Unapproved framing deviations and rotation of the floor framing relative to the supporting structure.

⁷ A rigid framework designed to support a structure.

deviated from the original plans and specifications and/or substituted approved materials. The report, dated December 9, 1997, states:

The overall structural system and lateral system has been severely compromised and it is recommended that the building not be inhabited until the entire structural system is constructed per contract documents. [original emphasis]

On or about December 11, 1997, the contractor hired a separate engineer to inspect the building and recommend structural fixes to ensure the integrity of the building. A fax transmittal on December 22, 1997, from the contractor to the engineer, states:

After your report is complete, we will prepare a change order for [the borrower] to sign, indicating his acceptance of the changes to the project. This will also have to be acceptable to [the architect].

The lender was also sent a copy of this transmittal. In a letter dated January 12, 1998, the architect informed the borrower that the changes would not be acceptable. A copy of this letter was also sent to the lender. In the letter, the architect states:

Neither we nor our consulting engineers are prepared to offer an opinion as to whether the proposal of [the contractor's engineer] is appropriate or adequate. As the architect of record...we must insist on strict performance of the original contract documents.... Under other circumstances, we might be able to be somewhat more flexible. Here, however, where the deviations represented such a radical departure from the original contract drawings, we have to disassociate ourselves from any alternated remedy, however well intended and conceived.

Because the architect left the project in January, he completed only 3 of 8 monthly inspections required in his contract with the borrower. No other inspections of the building were conducted after the December field visits.

A letter from the funds control agent to the borrower, dated March 12, 1998, stated that "the bank reviewed the failure to maintain a responsible architect on the project during construction and [found] that this was a major contributor to the problems you are currently experiencing." When we sent the lender a list of the conditions we noted,⁸ the lender indicated,

⁸ OIG provided the lender a written conditions statement at the preliminary exit conference. The conditions were not

in a written response dated April 5, 2001, that it “required,” “anticipated,” and “relied” on the architect to provide inspections during the construction and provide the lender with a certificate of occupancy at the conclusion of construction.

The architect’s consulting engineer completed a report on September 14, 1998 (see Exhibit B), subsequent to the completion of the structure, and noted 44 deficiencies that affected the structural integrity of the building. These deficiencies resulted from the contractor’s deviations from the original plans and specifications. The engineer indicated that these deficiencies “must be repaired to improve the structural integrity of the building as intended by our original structural design and drawings.” To support the assertion that deviations had occurred, the engineer referred in his report to an affidavit from a subcontractor that stated, “throughout the building, support footing for beam supports were all deleted.”

The borrower hired a second engineering firm to evaluate the significance of plan changes and the quality of construction of the building, and in a report dated September 28, 1999, the engineer concurred with the findings of fact noted in the September 14, 1998 report. In addition, the engineer concluded that:

The only way to achieve the quality facility represented by the construction documents would be to raze the existing structure and start over.

Figure 1 – Hotel as of 2/13/2001

OIG Photo

to be considered by the lender all-inclusive, but a guideline to facilitate the lender’s written response to OIG concerning the findings noted. OIG presented the lender the conditions statement on March 21, 2001, via facsimile.



The lender is responsible to approve, in writing, any deviations from the original plans and specifications. To facilitate the completion of the structure, the lender hired a construction fund control agency to act as its representative. A key control of the agency and lender was to initial off on any additions or changes made by the contractor to the plans and specifications approved by the architect. This control would ensure that the construction was completed in accordance with program rules and regulations.

We noted from discussions with the architect that the fund control agency was aware of the problems associated with the structural system of the building. The lender was provided copies of monthly inspection reports issued by the architect and copies of field alerts from the structural engineer that identified the deviations made to the structure of the building. We were unable to find any correspondence from the lender to the construction company, funds control agency, or architect to cease construction until corrections were made for the deficiencies noted. The construction of the building continued, which further complicated the ability to correct the problems associated with the integrity of the structure.

In its written response to our conditions statement, the lender noted it became aware of the deviations from the architect. The lender stated that it arranged for a separate engineering firm to evaluate the situation and to provide remedies for deficiencies noted. The lender indicated construction funds were not disbursed until the repairs were completed and until it had received assurances from the engineering firm that all structural problems had been remedied. However, we could find no documentation that any engineering firm and/or architect of record offered assurances that all the

deviations and deficiencies were remedied.

The lender did not approve all deviations or attempt to ensure corrections of the deficiencies as soon as they were brought to its attention. We believe the lender was negligent in servicing this loan because it failed to provide the necessary oversight during construction and did not stop the construction of the building as soon as the structural integrity of the building was questioned.

Lender did not require building inspections during construction

The lender did not ensure that the required building inspections were completed during the construction of the project. The lender relied on architectural inspections and did not follow up with the local building authorities after it discovered some confusion over jurisdiction. As a result, the lender was unable to obtain the required building certifications ensuring that the structure was built according to the plans and specifications and in accordance with the local building code.

Rural Development's conditional commitment⁹ states:

The lender will monitor the progress of construction and undertake the reviews and inspections necessary to ensure that construction conforms with applicable Federal, State, and local code requirements

This includes providing Rural Development with the "Lender's Certifications" as outlined in Rural Development instructions.

The lender's "Standard Construction Loan Requirements"¹⁰ states:

Prior to final disbursement...a certificate of occupancy [will be] issued by the appropriate governmental authority, [and a] Certificate of Completion executed and acknowledged...

In addition, the construction loan agreement¹¹ states:

Lender shall furnish to Rural Development a certification by an engineer, architect, or other qualified inspector that the construction has complied and will continue to comply with

⁹ Exhibit A of the conditional commitment dated March 10, 1997.

¹⁰ Addendum to the closing letter signed by the lender and borrower dated August 13, 1997.

¹¹ Lender's Construction Loan Agreement dated August 13, 1997 and the lender's Standard Construction Loan Requirements attached to the closing letter signed by the lender and borrower.

all applicable statutes, ordinances, codes, regulations, and similar requirements.

A certificate of occupancy would verify that the structure was built in accordance with Federal, State and local building codes and that the building was safe for occupancy. However, prior to the start of construction, there was confusion over which governmental entity, if any, had jurisdiction over the land. The county building authority determined the land was not under county jurisdiction because the building was located within the Indian reservation.

The lender told Rural Development that it had hired its own building inspector. We noted that Rural Development officials were under the assumption that this “inspector” would be onsite to verify the work as it was completed. Rural Development officials were surprised to find out the “inspector” was actually a funds control agent and was responsible for verifying the percentage of work completed and authorizing release of payments to contractors. We received documentation from the “inspector” describing his duties and determined at no time was he hired to verify that the construction met with approved plans and specifications or that the building was built to applicable building codes.

Instead of contracting with an inspection company, the lender elected to rely on inspections completed by the architect to ensure the building was constructed in accordance with applicable building codes. We noted, however, that the architect’s contract with borrower required the architect to provide “construction administration” only. “Construction administration,” as defined by the contract, consisted of monthly inspections the architect was to perform to make himself generally familiar with the progress and quality of the work and to determine in general if the work when completed would be in accordance with the contract documents. We concluded this was not adequate for the magnitude of the project and would not adequately ensure compliance with all building codes.

The architect disassociated himself from the project in January 1998¹² because of the substantial and radical deviations from the original plans. No further architectural inspections occurred from January 1998, to the end of the project, when the hotel opened on September 9, 1998.

A lender’s interoffice memorandum dated July 21, 1998, and addressed to the senior loan committee, requested the additional \$650,000 to complete the project. The memorandum explained the reasons for the cost

¹² In a letter dated January 12, 1998, to the borrower. A copy was sent to the lender.

overruns, stating “there has been a great deal of reliance on architectural inspections.... The failure of the architect to notice and approve or reject major design change has added to the delays in construction and increased costs.” As noted above, the architect stopped performing inspections in January 1998. Furthermore, the conditions of the loan place the responsibility on the lender to approve all contract document change orders and to ensure the project is built in accordance with plans and specifications.

The architect noticed the structural deviations in the building during an October 1997 inspection. In a November 21, 1997 report, the architect noted that the “floor framing [was] not installed per structural plans.” The structural engineers filed a “Field Alert,” dated December 9, 1997, stating the “...structural system...has been severely compromised and it is recommended that the building not be inhabited...” The lender, through its funds control agent, received a copy of the alert and became aware of the problems associated with the project. However, the lender failed to act on the conditions.

In addition, we noted that the borrower, preparing for litigation, contracted with a separate engineer to evaluate the construction modifications and structural performance and make recommendations. A report was presented to the borrower on September 28, 1999. This report states:

The first 'error in judgment' was to proceed without a building permit....You [the borrower] were left without proper (and desirable) review and inspection services to which you would normally have been entitled. Contractors often resent the inconvenience of having to schedule inspections with the Building Authority.... The "permit process" serves to protect the owner as well as the public, and the inspections performed by the Building Department are to assure that critical portions of the work are performed in strict accordance with the permit drawings.

The engineer reached the following conclusion in his report:

In my opinion, there is no way to "undo" the damage which has resulted from the myriad [of] modifications and substitutions ...implemented in lieu of the detailing and specifications indicated on the contract drawings. The only way to achieve the quality facility represented by the construction documents would be to raze the existing structure and start over.

None of the principals involved – not the lender, borrower, architect, nor engineer - can assure Rural Development or the public of the safety of the current building. The lender appeared to rely on assumptions that “someone” would inspect, review, approve, and sign-off on the project at the completion of the building. Because the lender failed to obtain the required inspections during the construction process, it was subsequently unable to obtain a certificate of occupancy from the appropriate government entity or a certificate of substantial completion from the architect.

We concluded the lender was negligent in its servicing because it failed to ensure that the required inspections were obtained; it was and still is unable to certify that the project was built to contract documents and in accordance with the applicable building codes. Nevertheless, the lender certified¹³ to Rural Development that the inspections were completed and that the project met all plans and specifications. On August 19, 1998, the lender certified that

...all development will be substantially completed in accordance with plans and specifications and will conform with applicable Federal, State, and local codes. There have been some deviations from the original plans and specifications, however, those are being remedied, inspected, and will be signed off by the architect and engineer prior to final disbursement.

In the lender's written response to OIG,¹⁴ the lender stated that it "required" construction inspections by the architect, that it "relied" on the owner and general contractor to ensure that the construction was completed in accordance with applicable building codes, and that it "believed" the final approval of the project, prior to occupancy, would come from the Indian reservation building authority. After determining the authority would not perform the inspections, the lender required that the original architect be retained to conduct the inspections during the course of construction. The lender "anticipated" the architect would issue the certificate of substantial completion at the conclusion of the project.

In conclusion, we determined the lender, prior to and during construction, was aware of the problems associated with obtaining the required inspections and building certifications for the project. The failure of the lender to act in a prudent manner to obtain the inspections is negligent

¹³ Lender certifications to Rural Development were dated August 19, 1998 (\$2.050 million loan) and December 15, 1998 (\$650,000 loan) certifying all conditions of the loan agreements have been met.

¹⁴ Lender's April 5, 2001, written response to OIG's conditions noted at the exit conference.

servicing. The lack of inspections put the project at risk and could place the occupants of the building at risk.

Lender did not obtain payment and performance bonds as required by loan documents

The lender did not obtain the required payment and performance bonds from the contractors before construction began. This occurred because the lender was unaware the construction loan agreement required the bonds and believed that because the owner would function as the owner/general contractor, no bonds would be necessary. As a result, the lender had not fulfilled the conditions set forth in the loan note agreements and placed unreasonable financial risk on the lender and Government concerning the construction of the project.

The construction loan agreement,¹⁵ dated August 13, 1997, states:

If requested by lender, borrower shall have furnished a performance and payment bond in the amount equal to 100 percent of the amount of the construction contract...naming the General Contractor as principal and lender as an additional obligee.

According to the lender's "Standard Construction Loan Requirements,"¹⁶ the lender required the borrower to obtain 100 percent payment and performance bonds from any contractor hired for the project. However, no payment and performance bonds were evident.

The lender indicated in its written response to OIG that it waived the requirement for payment and performance bonds since such bonds are not issued to an owner/contractor and since no bonds are required when the borrower acts as the general contractor. However, Rural Development's conditional commitment dated March 10, 1997, states:

No provisions stated herein shall be changed without the prior written consent of the USDA, Rural Development."

We were unable to find any written documentation from Rural Development approving the waiver of the payment and performance bond requirement. Furthermore, the construction loan agreement clearly

¹⁵ Construction Loan Agreement signed by the lender and borrower at loan closing (8/13/97) includes provisions in which the lender and borrower need to follow. Rural Development included these agreements within its conditional commitment.

¹⁶ This agreement was referred to in the closing letter to the borrower dated August 13,, 1997. The lender required compliance with the conditions set forth in the agreement.

requires a 100-percent payment and performance bond and states that the contractor must be bondable. The construction loan requirements further state that:

In the event of owner-builder – bonds must be obtained from Major Subcontractors showing owner as Obligee and [lender] as Co-obligee.

We concluded the lender was not allowed, without prior approval from Rural Development, to waive the requirements in the loan note agreement. The lender was required to obtain the bonds from the contractor or any subcontractors hired for the project.

Loss Payment to the Lender Should Reflect Negligent Servicing

We concluded because of negligent servicing by the lender, Rural Development should consider rescinding the loan note guarantee totaling \$2,365,000. As shown in this report, the lender was negligent in that it did not require the borrower to meet a total of seven conditions and covenants of the loan note agreements and the Rural Development conditional commitment. Specifically, the lender did not ensure that:

- all proposed change orders would receive written lender approval,
- a certificate of occupancy for the hotel was issued and all required inspections occurred,
- an architect's certificate of substantial completion was issued,
- 100 percent payment and performance bonds were received from contractors and subcontractors,
- construction was completed according to approved plans and specifications, with applicable architectural inspections and certifications,
- the building was in compliance with all Federal, State, and local codes, and
- the lender, the architect, and the borrower accepted all completed improvements

The lender was either unaware these requirements existed or, because of the lack of oversight prior to and during construction, was unable to obtain the required certifications set forth in the loan agreements. As noted

above, the lender is required to adhere to the covenants and provisions set forth in the loan agreements, and is not able to waive any conditions of the loan, without specific approval from Rural Development. We determined no such approvals were given to the lender from Rural Development.

Because of the lender's negligent servicing, the hotel built with the \$2.7 million guaranteed loans may be unsafe and have to be torn down.

RECOMMENDATION NO. 1

In consultation with the Office of the General Counsel, rescind the loan note guarantee to the lender to eliminate any future loss claims by the lender against Rural Development.

Agency Response

In its written response to the draft report, dated August 2, 2001, the Arizona Rural Development concurred with the key recommendation to rescind the loan note guarantee to eliminate any future loss claims by the lender. RD stated that they will discuss with the National Servicing Division the steps to be taken to begin this process

OIG Position

To reach management decision for this recommendation we need a copy of the correspondence notifying the lender that Rural Development is rescinding the loan note guarantee.

EXHIBIT A – SUMMARY OF MONETARY RESULTS

Finding No.	Description	Amount	Category
1	Negligent servicing by the lender resulted in a structurally flawed building	\$2,365,000	Unsupported Costs and Loans – Recovery Recommended

EXHIBIT B – ENGINEER REPORT DATED SEPTEMBER 14, 1998

STRUCTURAL REPORT
For
NAVAJOLAND DAYS INN
ST. MICHAELS, ARIZONA

September 16, 1998

Prepared for
DINÉ BIGHAN DEVELOPMENT, INC.
P.O. BOX 875
ST. MICHAELS, ARIZONA 86511

by
KPFF CONSULTING ENGINEERS, INC.
2800 North Central Avenue, Suite 1010
Phoenix, Arizona 85004-1007

Project No. 96070.8

kpff
Consulting Engineers

**STRUCTURAL REPORT
NAVAJOLAND DAYS INN, ST. MICHAELS, ARIZONA**

TABLE OF CONTENTS

SECTION	PAGE
Structural Deficiencies at Roof Level, Sheet S2.3	2
Structural Deficiencies at Second Floor Level, Sheet S2.2	4
Structural Deficiencies at First Floor Level, Sheet S2.1	6
KPFF Field Alert Dated December 9, 1997	Appendix A
KPFF Letter to [] Architects Dated January 12, 1998	Appendix B
[] Engineering Corporation Fixes, Dated January 6, 1998	Appendix C
[] Construction Affidavit, Undated	Appendix D
KPFF Structural Peer Review of [] Engineering Fixes Dated February 19, 1998	Appendix E
KPFF Field Alert Dated July 20, 1998	Appendix F
Truss Shop Drawings and Calculations for the Roof and Floor Trusses Dated August 7, 1998	Appendix G
Photos Taken on December 9, 1997, July 20, 1998, and Photos Received from Contractor on December 9, 1997.	Appendix H
Letter from SGG, Incorporated, Dated September 1, 1998	Appendix I
Sheets S2.1, S2.2, and S2.3 Showing Location of the Photos	Appendix J

KPFF Consulting Engineers - September 14, 1998

September 14, 1998

[]
Dine' Bighan Development, Inc.
P.O. Box 875
St. Michaels, Arizona 86511

Reference: Navajoland Days Inn, St. Michaels, AZ
Kpff Project No. 96070

Dear []

The following report and appendices are a compilation of previously identified structural deficiencies at Navajoland Days Inn that must be repaired to improve the structural integrity of the building as intended by our original structural design and drawings. These deficiencies have been determined based upon the following:

- Contract Structural Drawings by KPFF Consulting Engineers, dated October 18, 1996.
- Observations made during site visits on December 9, 1997 and July 20, 1998.
- Photographs taken by KPFF or received from the Contractor during those site visits.
- Floor and roof truss calculations and shop drawings received in December of 1997, the resubmittal of these calculations and shop drawings dated August 7, 1998, and additional floor truss calculations and shop drawings dated August 7, 1998.
- Written correspondence that was sent to KPFF regarding this project.
- KPFF Structural Peer Review of [] Engineering fixes dated, February 19, 1998.

The statement and opinions developed by this report are based on sound engineering knowledge and judgment constrained by the scope of work and consistent with that level of care and skill ordinarily exercised by members of the profession currently practicing in the same locality under similar conditions. No other representation, expressed, or implied, and no warranty or guarantee is included or intended.

This report is prepared for the sole use of Dine' Bighan Development, Inc. and is considered confidential and proprietary data. The report presents the evaluation and opinions of KPFF Consulting Engineers regarding the structural integrity of the building and is not intended for the use of others.

Visual observation of both the exterior and interior of the structure was performed on elements of the structure that were made accessible at the date and time of KPFF's site visits. This report does not address any non-structural portion of the building.

STRUCTURAL DEFICIENCIES AT ROOF LEVEL - SHEET S2.3

1. The roof truss blocking panels specified in Details 1/S3.3 and 4/S3.3 have not been installed along the north and south exterior walls between grids 1 to 3.7 and from grids 24.3 to 27. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 10 of the KPFF letter to Architect dated, January 12, 1998; and Item 10 of the KPFF Structural Peer Review of Engineering fixes dated, February 19, 1998; and Photo 16.
2. None of the roof truss blocking panels that were installed appear to have boundary nailing of the roof diaphragm to the top chord of the panel per Details 1/S3.3 and 4/S3.3. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 10 of the KPFF letter to Architect dated, January 12, 1998; Item 10 of the KPFF Structural Peer Review of Engineering fixes dated, February 19, 1998; Item 19 of the KPFF Field Alert dated, July 20, 1998 and Photo 24.
3. The field "fixes" for the full span trusses between grids 1 and 4 and between grids 24 to 27 have not been completed as specified by the truss manufacturer. Reference recommended truss fixes by Houston Truss, Farmington and Photo Numbers 16 & 26. The truss manufacturer has not submitted complete calculations and detail notes for these fixes. These revised truss details were not submitted to KPFF prior to August 10, 1998.
4. The web braces have not been placed at any of the roof truss webs as specified by the truss manufacturer. Reference roof truss calculations submitted by Houston Truss, Farmington; Item 8 of the KPFF letter to Architect dated, January 12, 1998; Item 8 of the KPFF Structural Peer Review of Engineering fixes dated, February 19, 1998; and Photo Numbers 16, 26, and 28.
5. None of the roof beams along the outside edge of the balcony at the north and south side of the project (RB2, RB3, RB5, RB8, and RB10) and the RB9 roof beams at the east and west ends of the building (grid 1 to 3 and grid 25 to 27) were installed by the contractor. There are approximately 40 beams that were not installed. Reference Item (J) of the KPFF Field Alert dated, December 9, 1997; Item 12 of the KPFF letter to Architect dated, January 12, 1998; and Items 5.b.iii, 8.a.3, and 23 of the KPFF Structural Peer Review of Engineering fixes dated, February 19, 1998 and Photo Numbers 1 through 14, 16, 18, 26, and 27.
6. Due to the omission of the roof beams listed in (5) above, the roof trusses from grid 2 to grid 26 cantilever approximately 9'-6" over the north and south balconies. Some of these truss drawings were revised and submitted to KPFF on August 10, 1998 (T09RV, T11, and T13RV) but approximately 50% of the cantilever truss drawings have not been submitted with calculations. The calculations submitted for this cantilevered condition do not reflect the extended ends of the trusses, do not have the correct snowload per '94 UBC for overhangs, and do not have the correct wind uplift loads per the '94 UBC for overhangs. The existing uplift loads result in a maximum uplift reaction of 873 lb. The Contract Documents are based on a design for only a 1' overhang and specify a single Simpson H2.5 connector - allowable uplift load = 415 lb. Existing uplift connection is not adequate for the loads specified. Reference truss calculations submitted by Houston Truss, Farmington; Item 12 of the KPFF letter to Architects dated, January 12, 1998; Item (g) & (j) of the KPFF Field Alert dated, December 9, 1997; Item 5.b.iii, 12, and 23 of the Recommendations section of the KPFF Structural Peer Review of Engineering fixes dated, February 19, 1998; and Photo Numbers 1, 2, 4, 7, 8, 9, 11, 12, 13, and 14.
7. The calculations for the roof trusses between grids 3.7 to 6.7 and 21.3 to 24.3 do not reflect the cantilevered end condition of the T12, T13, T15 and T17 trusses nor do they allow for the additional

loads from the overframing above. The GE05 truss is designed as being continuously bearing along the bottom chord but the as-built condition is three-point bearing with balcony ceiling framing spanning from the ends of the T12, T13, T15, and T17 trusses to the GE05 "gable end" truss resulting in higher loads. Reference Item 8.i.2 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998 and photos 2, 3, 4, 9, 13, and 14. These trusses must be analyzed to ensure that they are not overstressed.

8. The V-Series overframing trusses are not connected to the truss framing below per Detail 6/S3.3. The 2x8 "valley boards" and Simpson A34 connectors have not been installed per plan. Reference the plan note on Sheet S2.3, the redlined comments of the roof truss shop drawings stamped as "NON-CONFORMING, REVISE AND RESUBMIT" dated, December 29, 1997; Item 22 of the KPFF Field Alert dated, July 20, 1998; and Photo 25.
9. The trusses at the north-south running shear walls have not been designed as drag trusses with 350 PLF drag force loading per Detail 3/S3.3. The trusses at these locations have not been connected to the shear walls below per Detail 3/S3.3 of [redacted] Engineering's proposed corrections, and the braces have not been installed per Note 10 on 3/S3.3. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 9 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 9 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering corrections dated, February 19, 1998; redlined comments of the roof truss shop drawings stamped as "NON-CONFORMING, REVISE AND RESUBMIT" dated, December 29, 1997; Item 23 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 22, 28, and 64.
10. The contractor added a glulam beam at the roof level along grid 0.9 from grid 10 to grid 12. The T11 and T11A roof trusses specified by the truss manufacturer are designed to be bearing at the wall approximately 5'-4" north of grid E. No engineering, RFI's, or shop drawings were submitted to KPFF for this change. This beam bears on "columns" that bear on the vertical member of the F01 and F02 floor trusses below. The calculations submitted for these floor trusses do not reflect these "column" loads. Reference Item (J) of the KPFF Field Alert dated, December 9, 1997; Item 5 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 5.b.iii, 8.ii.2, 12a and 21 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 14 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 53, 54, and 56.
11. The prefab truss panel, boundary nailing at the ridge, Simpson H2.5 uplift connectors, and continuous full width top plate have not been installed along approximately grid C as specified by Notes 1, 4, 6, and 10 on Detail 9/S3.3 referenced on Sheet S3.3. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 10 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 10 of the KPFF Field Alert dated, July 20, 1998; Item 18 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 17 and 23.
12. None of the gable end trusses have been braced per Detail 7/S3.3 referenced on Sheet S2.3. Reference Item 17 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 5, 10 and 26.
13. The roof beams along grids B and D spanning from grids 2 to 3 and spanning from grids 25 to 26 have not been installed per the Contract Documents. The Contract Documents specify that the T04 trusses be six-point bearing; the T04 trusses as supplied were designed as four-point bearing (grids A, B, D, and E) and the existing trusses are two-point bearing. KPFF provided SCG, Incorporated with a recommended alternate modification along the grids B and D bearing points only. Reference the RFI response to SCG dated, July 30, 1998; Item 8 of the KPFF letter to [redacted] Architect dated, January 12, 1998; redlined comments of the roof truss shop drawings stamped as "NON-

CONFORMING, REVISE AND RESUBMIT" dated, December 29, 1997; Item 8 and 12 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item (j) of the KPFF Field Alert dated, December 9, 1997; Item 20 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 5, 6, 10 and 11.

14. The exterior walls from roof level to the 2nd floor level have increased loads due to the cantilevered roof trusses. A structural analysis must be done of these walls, the shear transfer to the shear walls below (see Item 11 of this report), the shear transfer from the roof diaphragm to the exterior shear walls, all the existing roof-level headers, columns, and glulam beams with increased load due to the reconfiguration of the roof trusses, and all existing roof trusses that do not reflect the proper loading condition or existing configuration. All the existing bearing walls that do not have the grade of lumber specified must also be analyzed. Reference Items (b), (e), (f), & (j) of the KPFF Field Alert dated, December 9, 1997; Items 1, 5, 6, 10, 12, and 13 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Items 1, 5, 6, 10, 12, 13, 15, 17, 21, and 23 of the KPFF Field Alert dated, July 20, 1998.

STRUCTURAL DEFICIENCIES AT SECOND FLOOR LEVEL - SHEET S2.2

15. The F01 and F02 floor truss calculation do not reflect the column loads from the glulam beam above where the contractor added a roof beam. The columns above and vertical members of the floor trusses below must be analyzed for structural stability of the existing framing configuration. Reference Item (j) of the KPFF Field Alert dated, December 9, 1997; Item 5 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 5.b.iii, 8.ii.2, 12a, and 21 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 14 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 53, 54, and 56. Also reference Item 10 of this report. These trusses shop drawings and calculations were not submitted to KPFF prior to 8/10/98.
16. The F06 floor girder truss bearing at grids 11.7 and approximately 5'-4" north of gridline B does not bear at a panel point. This truss bottom chord must be analyzed to ensure that it is not overstressed. The truss calculations that were submitted on August 10, 1998 specify Node No. 1 of the F06 floor truss as bearing. This end of the truss is framed as a cantilevered end. There is no framing member below this point to provide bearing for that point of the truss. This truss must be analyzed as a cantilevered end to ensure that the truss is not overstressed. Reference Item 19 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; and Photos 51 & 52. This truss shop drawing and calculations was not submitted to KPFF prior to August 10, 1998.
17. The F02 floor trusses assume a bearing point at grids B and D between grids 2 to 3 and grids 25 to 26. The B1 beams and columns at these locations have not been placed per contract documents. A structural analysis must be done to determine the size of beam and columns required at these locations. Reference Item (j) of the KPFF Field Alert dated, December 9, 1997; Item 5 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 5 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 8 and 11 of the KPFF Field Alert, dated July 20, 1998; Photo Numbers 6 and 10, and the truss calculations submitted by Houston Truss, Farmington.
18. All the perimeter beams at the balcony edges have been replaced with girder trusses provided by and designed by Houston Truss, Farmington. The FH and FE girder trusses do not reflect the loads from the center column supporting the GE05 gable end truss above. Reference the truss shop drawings submitted by the truss manufacturer, Item 18 of the Recommendation section of the KPFF Structural

Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 3 of the KPFF Field Alert, dated July 20, 1998; and Photo Numbers 2, 3, 4, 14, 33, 34, and 36.

19. The truss manufacturer did not provide/submit hanger sizes for any of the truss to truss or truss to girder truss connections as specified by the Wood Truss Council of America. Several of these connections that were observed on July 20, 1998 did not have any hangers installed. All of the TH type hangers that were used at the F06 floor girder truss are fastened to and transferring vertical load to the web members of the girder truss. This condition must be analyzed to ensure that the web members are not overstressed. Reference Item 3 of the KPFF Field Alert, dated July 20, 1998; and Photo Numbers 34, 35 and 36. The truss manufacturer shall provide hanger sizes for all truss to truss or truss to girder truss connections.
20. There are no shear transfer panels between the floor trusses at any of the bearing walls or shear walls for lateral stability and force transfer. A structural analysis must be done to determine the type of shear panels required to transfer shear from the shear walls above and the floor diaphragm to the shear walls below. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 10 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 10 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 1 of the KPFF Field Alert, dated July 20, 1998; and photos 8, 15, 31, 34, 37, 38, 39, 40, 41, and 42.
21. A structural analysis must be done of the shear transfer from the floor diaphragm to the shear walls below that are parallel to the existing floor trusses. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 10 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 10 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; and photo 37.
22. The contractor placed a glulam beam along grid C from grid 2 to 3.3 and from grid 24.7 to 26 to carry the end of the F02 and F03 floor trusses. A structural analysis of these beams and "columns" must be done to ensure that the beams and columns at these locations are not overstressed. Reference Item (j) of the KPFF Field Alert dated, December 9, 1997; Item 5 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 5 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; and Item 11 of the KPFF Field Alert, dated July 20, 1998.
23. The F11 floor trusses that are bearing along the 2x wall approximately 8' south of grid A between grids 13 to 14 and grids 8 to 10 are not bearing at panel points and appear to be overstressed. The bottom chord of three trusses must be analyzed to ensure that they are not overstressed. Reference Item 2 of the KPFF Field Alert, dated July 20, 1998; and Photo Numbers 7, 8, 12, and 15.
24. The bearing walls that are carrying the T19 roof trusses along grids 10 and 13 from grid B to approximately 9'-6" south of grid A are bearing on the top chord of the T13 roof trusses below and do not have any uplift connectors. The T13 truss calculations do not reflect this load (1190 PLF per T19 truss calcs) along the top chord. Part of the load from the bearing wall above appears to be bearing on the cantilevered end of the F10 floor truss below. The truss calculation for this truss does not reflect this additional load. All of the trusses at these locations must be analyzed with the appropriate loads to ensure that none of the existing truss members are overstressed. Appropriate uplift connectors must be provided to resist upward loads. Reference Item 8.a.i.2 and 8.a.ii.2 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 2 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 7, 8, and 33.

25. The B17 beams along grids 10.3 and 12.8 are not bearing on the B21 beams per Detail 15/S3.3 but instead are bearing on the stud wall approximately 12' south of grid A. The "columns", headers, and footings below this bearing must be analyzed to ensure that the columns, headers and footings below are not overstressed. Reference Item 13 of the KPFF letter to [redacted] Architect dated, January 12, 1998; and Item 22 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998.
26. The B2 beam at the edge of the stair landing at the north side of the lobby and the 3" diameter steel pipe column below has not been installed as specified on the Contract Documents. The F03 floor trusses in this area have been designed to cantilever across the B5 beam and work without the B2 beam. The 3" diameter steel pipe column must be installed and the footing placed below per Contract Documents to provide bearing for the steel stair landing above. The B2 beam must be installed or the B5 beam, columns, and footings below must be analyzed to ensure that the revised floor framing system is structurally adequate. Reference Item 5.b.ii of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 13 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 53, 55, and 56.
27. The F10 and F13 floor trusses that are bearing along the glulam beam along grid C between grids 11 to 13 are approximately 3" too short and do not bear on the glulam beam but only on a double 2x4 ledger nailed to the sides of the glulam beam. Reference Item 5.b.iv of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 12 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 29, 30, 31, and 32. KPFF provided SGG Incorporated with a recommended solution/fix for this area. Reference the Detail and notes faxed to SGG on July 30, 1998.
28. The floor trusses in the lobby area are bearing on the B3, B4, B5 and B16 glulam beams. All of the beams at the floor level must be analyzed to ensure that the beams or headers are not overstressed due to rotation of the floor framing or beams that have been left out. Reference Item 5 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998.

STRUCTURAL DEFICIENCIES AT FIRST FLOOR LEVEL - SHEET S2.1

29. All of the columns or built up columns at the foundation to the 2nd floor and 2nd floor to roof that have increased loading (including uplift) must be analyzed to ensure that the columns are not overstressed. All columns, post bases, and post caps shall be verified by the contractor. Reference Item (k) and the note on page 3 of the KPFF Field Alert dated, December 9, 1997; Item 6 and 13 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Items 6 and 13 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998 and Items 4, 10, and 15 of the KPFF Field Alert dated, July 20, 1998.
30. All of the bearing walls with increased loading or with lumber grades that are not per Contract Documents must be analyzed to ensure that the studs or plates are not overstressed. Reference Item (b) of the KPFF Field Alert dated, December 9, 1997; Item 1 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 1 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Items 4, 5, and 6 of the KPFF Field Alert dated, July 20, 1998.
31. At the time of the site visit on July 20, 1998 the majority of the Simpson MIT28B and PHAD42 holdowns were either not installed or were installed improperly. The contractor shall verify the installation of all Simpson MIT28B and PHAD42 holdowns and the ST6236 holdowns straps per Contract Documents. Reference Item (d), (m), and (l) of the KPFF Field Alert dated, December 9, 1997; Item 11 of the KPFF letter to [redacted] Architect dated, January 12, 1998; ; Item 11 of the KPFF

Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; and Items 8, 9, and 10 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 60, 61, 62, and 63.

32. During the December 9, 1997 site visit it was noted that none of the shear walls appeared to have anchor bolts fastening the bottom plate of the shear walls to the concrete. Reference Item (c) of the KPFF Field Alert dated, December 9, 1997; Item 4 of the KPFF letter to [redacted] Architect dated, January 12, 1998; and Item 4 of the KPFF Structural Peer Review of [redacted] Engineering corrections dated, February 19, 1998. Several of these shear walls plates were observed during the July 20, 1998 site visit and no shear wall bolts were observed. These bolts shall be installed per Contract Documents. Reference Item 7 of the KPFF Field Alert dated, July 20, 1998; and Photo 58.
33. The existing columns and footings below the end of the roof beam that was added by the contractor (reference Item 10 of this report) at grids D.9-10 and D.9-12 must be analyzed to ensure that the columns, footings, and soil below the footings are not overstressed. The existing footings must be field verified. Reference Item (e) of the KPFF Field Alert dated, December 9, 1997; Item 10 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 18 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 53, 54, and 56.
34. The existing columns and footings at the bearing points of the F01 F02 and F06 floor trusses must be analyzed to ensure that the columns, footings, and soil below the footings are not overstressed. Reference the floor truss shop drawings submitted by Houston Truss, Farmington. Item 7 and 8 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 7.a of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 14 of the KPFF Field Alert dated, July 20, 1998; and Photo Numbers 51 and 54.
35. The footing at grids C-2, C-3.3, C-24.7, and C-26 must be analyzed to ensure that the footings and the soil below the footings are not overstressed due to increased loading from the rotated floor framing. Reference Item (j) of the KPFF Field Alert dated, December 9, 1997; Item 7 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Item 7 of the Recommendation section of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; Item 11 of the KPFF Field Alert, dated July 20, 1998; and Item 22 of this report.
36. Contractor photos of the slab on grade being poured shows that the 2" of sand and 10-mil visqueen was not placed per the plan note on Sheet S2.1. Reference Photo Numbers 69 and 70.
37. All of the spread footings in the lobby have increased loads due to the rotation of the floor framing and cantilevered ends of the roof trusses above. All of the existing spread footings that have increased loads with respect to the Contract Documents must be analyzed to ensure that the footings and the soil below the footings are not overstressed. Reference Items 7 and 13 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Items 7.a.ii, 13, 15, and 20 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; and Items 24 of the KPFF Field Alert dated, July 20, 1998. All of the existing spread footings shall be verified to ensure that the spread footings assumed in the analysis have been placed. Reference Appendix D, the affidavit from [redacted] Construction; third paragraph - "Throughout the building, support footing for beam supports were all deleted."
38. Most of the column locations at the perimeter of the balcony have been moved or eliminated. These "columns" and the foundations below must be analyzed to ensure that the existing "columns"/framing, footings, and the soil below the footings are not overstressed. During the July 20, 1998 site visit one of these "columns" was opened up to verify the existence of column/post, post base, and holdowns specified in Detail 1/S2.1. No post, post base, or holdowns were observed.

Reference Item 10 of the KPFF Field Alert dated, July 20, 1998; Item (m) of the KPFF Field Alert dated, December 9, 1997; and Item 20 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998.

39. All of the bearing stud walls, shear walls, beams and "columns" on this project shall be analyzed with the loading that reflects the existing framing at the floor and at the roof. The analysis shall be per the 1994 Uniform Building Code and shall reflect the stress grades of the existing lumber grades on site. None of the studs observed were of the stress grade specified by the Contract Documents. All of the existing footings below the bearing walls shall be analyzed and verified to ensure that the footings and the soil below the footings are not overstressed. Reference Item (b) of the KPFF Field Alert dated, December 9, 1997; Items 1, 2, 3, 4, 13, and 15 of the KPFF letter to [redacted] Architect dated, January 12, 1998; Items 1, 2, 3, 6, 7, 13, 15, 17, 19, 21, and 24 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998; and Items 4, 5, 6, 8, 10, 14, and 15 of the KPFF Field Alert dated, July 20, 1998.
40. The uplift at the first floor transverse shear walls where there has been a decrease in dead load due to the rotated floor framing must be analyzed to ensure that the holdowns specified in the Contract Documents are structurally adequate. Reference Item (i) of the KPFF Field Alert dated, December 9, 1997; Item 11 of the KPFF letter to [redacted] Architect dated, January 12, 1998; and Item 11 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998.
41. The shop drawings have not been submitted for the glulam beams as specified by the General Structural notes on Sheet S1.1. The contractor shall submit the layout drawings and stress grades of all the manufactured glulam beams that were installed on the project. Reference the General Structural notes on Sheet S1.1 and Item (n) of the of the KPFF Field Alert dated, December 9, 1997.
42. The diaphragm nailing of the 1/2" plywood at the second floor framing must be analyzed to check if the nailing is structurally adequate with the framing and plywood rotated ninety degrees. Reference Item (i) of the KPFF Field Alert dated, December 9, 1997; Item 14 of the KPFF letter to [redacted] Architect dated, January 12, 1998; and Item 14 of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998.
43. The roof truss, floor truss, girder truss layout and calculation must be resubmitted with corrections as noted by the clouded comments on the shop drawings attached. See Appendix G of this submittal.
44. The contractor shall verify that all of the double top plates are nailed together with 10 - 16d nails at the splice connectors per plan note (1) on Sheet S2.2 and S2.3. Reference Item (l) of the of the KPFF Field Alert dated, December 9, 1997 and Item 2.C of the of the KPFF Structural Peer Review of [redacted] Engineering fixes dated, February 19, 1998.

Please call should you need any further information.

Sincerely,

cc: [redacted]

S:\dr\lctm\96\obj\95070-8f

KPFF Consulting Engineers - September 14, 1998

EXHIBIT C – AUDITEE RESPONSE TO DRAFT REPORT



RURAL
DEVELOPMENT

ARIZONA STATE OFFICE
3003 N. Central Ave, Suite 900
Phoenix, AZ 85012-2906
(602) 280-8745
(602) 280-8705 TDD
(602) 280-8730 (FAX)


August 2, 2001

Subject: Audit Response to Draft Report No. 34601-4-SF
Rural Development-Lender Servicing of Business & Industry
Guaranteed Loans – State of Arizona, Lender B

To: Sam W. Currie
Regional Inspector General for Audit

Arizona Rural Development concurs with the Key Recommendation to rescind the loan note guarantee to the lender, Community First National Bank, to eliminate any future loss claims by the lender against Arizona Rural Development. Rural Development personnel will be in Charlotte, NC for the annual Business & Industry Policy meeting during the week of August 6-10, 2001 and will discuss with the National Office Servicing Division the steps to be taken to begin this process. We will then follow up with OIG in writing during the week of August 13, 2001.

If you have any questions, contact Gary Mack at (602) 280-8717.


ERNEST WETHERBEE
Acting State Director

cc: Leonard Gradillas, B&CP Director
Gary Mack, B&CP Specialist
Gwen Halls, Management Control Officer

Rural Development is an Equal Opportunity Lender, Provider and Employer
Complaints of Discrimination should be sent to:
USDA, Director, Office of Civil Rights, 326-W Whitten Bldg., Washington, D.C. 20250-9410