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Mortgagee Informational Bulletin #16

The Detroit Multifamily Hub has implemented this informational bulletin to keep mortgagees up to date with changes or news from our Hub relating to development issues. We're happy to cover any issues in the bulletin on which you have questions; the bulletins are issued on an as-needed basis.

Non-Critical Repair Escrows Under 223(f)

The Detroit Hub has noted that many of the projects that have closed with a Non-Critical Repair Escrow are not completing the required work within the 12 months allotted under the Escrow Agreement. In fact, there is a trend where repairs are actually taking nearly double the time to get accomplished. The Lender is responsible for monitoring construction progress to ensure repairs are timely made. HUD will contact the Lender when we become aware the repairs are not completed per the Escrow Agreement and ask for a plan and timeframe to get the repair work completed. Keep in mind, under the terms of the Escrow Agreement, if the work is not completed within the 12 month deadline, the Lender must take steps to ensure the work is completed, even if it means the Lender hires a contractor to ensure the work gets done.

In addition to the above, and as previously discussed in Mortgagee Bulletin #15, in cases where an owner elects to complete non-critical repairs prior to closing, HUD will only reduce the repair escrow if a HUD Construction Analyst is able to visit the site and verify the completion of the non-critical repairs at least 30 days prior to closing. In addition, any amendment request and form changes must also be delivered to HUD no later than 30 days prior to closing. Keep in mind, due to workload volume, a visit by the HUD inspector may not always be possible. In the case where a Construction Analyst is unable to verify completion of non-critical repairs, the entire amount will be escrowed and drawn down post closing using the normal draw procedure. If a Construction Analyst is able to verify completion of non-critical repairs prior to closing, HUD may reduce the non-critical repair escrow accordingly; however, the 2.5% required as a latent defects escrow will be maintained for 15 months after closing.

Fair Housing Act Requirements

The Detroit Hub has noticed an increase in application submissions where the subject project is built after 1991 but does not meet the accessibility requirements of the Fair Housing Act. The Fair Housing Act requires compliance for all projects built after 1991. You must keep in mind that the Fair Housing Act design and construction requirements are the law and the responsibility to comply with the law rests with the owner and design architect. The Detroit Hub has been asked to waive the requirements of the Fair Housing Act on several cases; however, because it is a statutory, the Hub is unable to waive any of its provisions. Therefore, if you have a project that does not comply with the Fair Housing Act's requirements, you must ensure that modifications that will allow compliance are made part of the noncritical repairs otherwise the Detroit Hub will have no choice but to reject the application.

Early Warning System

As many of you know, the Detroit Hub is currently in the midst of Multifamily Housing's "Breaking Ground – Delivering Results" initiative. As part of Breaking Ground, the Hub is implementing many new tools and processes to help it better deal with the increase in volume of applications. One tool that is being utilized is an "Early Warning System" or "EWS." The EWS will be used to screen applications once they are received to determine early on whether the application should be placed into processing or rejected and returned to the lender. As part of the EWS, staff will be looking at items such as debt service coverage, loan to value, ancillary income, expense ratio, average historical expenses, remaining economic life and cash out. You may want to keep the EWS in mind when submitting your applications.

Underwritten Expenses

As part of the Hub's emphasis on risk mitigation, it has instituted a tracking system for all projects whereby after closing and for up to one year afterwards (or longer if warranted), both the Asset Management and Development divisions will track the performance of each project comparing how it was underwritten versus how it is actually performing. After 12 months of initial tracking, the Hub finds that underwritten income and occupancy tends to be on target; however, we have seen some major issues, in the majority of projects, where the actual expenses far exceed the underwritten expenses. In fact, on average, there is a 25-30% difference in the amount of expenses as underwritten vs. the actual amount post closing. We have started to track this by lender as well, and it is clear that some lenders are better than others when it comes to underwriting expenses. As we continue our tracking, I am asking all lenders to please revisit how expenses are being underwritten so that on future projects, the underwritten expenses more closely mirror the actual expenses post closing.

Personal Liability Under Paragraph 50 of the Regulatory Agreement

After receiving a number of inquiries about who needs to sign Paragraph 50 of the new HUD Regulatory Agreement, the Detroit Hub has received the following guidance from HUD HQ:

- The provision requires two signatures for project sponsors which are privately held ownership entities. One needs to be a live person and to sign in his/her individual capacity and the other can be a signature by a corporate officer that binds the parent sponsor entity. Every corporate officer does not need to sign, just the two who are most responsible for decisions about the real estate as identified in the Mortgage Credit analysis. The Mortgage Credit review has discretion to require additional signatories if warranted in a specific situation.
- For cases of publicly traded corporations or REITS, or non-profit organizations, the sponsor entity itself is acceptable, and in those cases personal liability is not typically expected by the signatories who are not expected to sign in their individual capacity.
- "or successors" to signatories are not allowed, except for successors of the corporate officers signing on behalf of a publicly traded corporation, REIT or non-profit.
- Riders to the regulatory agreement that attempt to limit a signatory's liability are not allowed.
- The fact that a project has been processed as an a7 versus another section of the Act is not relevant.

Appeal Process for Rejected Applications

In order to alleviate any confusion regarding the appeal process for rejected applications, effective the date of this Mortgage Bulletin, the following appeal process will be adhered to in the Detroit Hub. All rejections will be sent to the lender under the signature of the Director of Operations. The rejection letter will state that if the lender wishes to appeal the rejection, the lender will have 10 calendar days to submit its appeal in writing to the Multifamily Hub Director. The Multifamily Hub Director will issue a response to the appeal and that response will be final.