

Questions and Answers
Risk Mitigation Housing Notice (H 2010-11) and Mortgagee Letter (ML 2010-21)

Q&A's issued 10/20/2010:

Question 30: Is the Statutory Limit Criterion (#4) subject to the new loan limits? The Housing Notice and Mortgagee Letter discusses new loan ratios (e.g. 83.3% for market rate transactions) but the chart only applied those ratios to the other criteria.

Answer 30:

100% of the statutory limits for the dwelling units is included in Criterion #4, but the new Loan Ratios are intended to apply the Site and Cost Not Attributable calculations in criterion 4. The charts included in the Housing Notice and Mortgagee letter summarized the impact for the other criteria which are most commonly applicable.

Question 31:

This is a follow-up to the answer to Question #17 as to what will be required if a Section 223(a)(7) application is processed under MAP (as opposed to TAP) – for example, is an REO schedule for principals required?

Answer 31:

No, analysis of an REO schedule, like other aspects of mortgage credit review are not required for Section 223(a)(7) loans, (which are refinancing currently insured loans.) Similarly, the loan sizing parameters and other program requirements remain unchanged. Until further guidance is issued in the MAP Guide, process Section 223(a)(7) loans per outstanding guidance, except to the extent Section III.C of the Notice (H 2010-11) and Mortgagee Letter (ML 2010-21) explicitly addresses changes to Section 223(a)(7) program guidance.

Question 32: With the changes in the ML 2010-21 will we be receiving modified Commitment Templates with some of the new requirements? Such as the certified rent roll within 30 days prior to closing. And the release of cash / equity from loan proceeds requirements?

Answer 32: The multifamily loan documents, including escrow requirements, are being revised through rule making. Where Notice 2010-11 (ML 2010-21) requires a condition to the firm commitment, reference the ML (section and paragraph) in a Special Condition to the Firm Commitment.

- a. The rent roll should contain the standard Section 1010 warning language in the footer, and be evaluated by the lender to ensure consistency with the underwriting conclusions in the Firm Commitment.
- b. The Q&A's address specific escrow items, but, in general we can rely on the Lender to specify the form of the escrows. One exception (and there may be others identified) is the working capital escrow. We are consulting with OGC on this issue and further guidance will be issued.

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Question 33: The Technical review sheets in the MAP Guide will not address the new items that need to be reviewed for each technical discipline. Will we be receiving new review sheets / forms?

Answer 33: We are developing an underwriter punch list to replace the technical discipline questions in the MAP Guide. We expect this will be issued in a Housing Notice.

Question 34: For the review of the marketing plan (III.D.6), who is expected to review this document and what specifically do they review for?

Answer 34: Both the lender's underwriter and the Field Office team leader should review the marketing plan. Asset Management should comment in their review of the Firm Commitment application. Though not required, some lenders hire third party property management or leasing consultants to review such plans in large or complex deals or where the proposed property manager is not fully experienced.

Question 35: Under section III.A.4.c (page 5, top bullet point) concerning mortgage credit history: Over what period of time should the review look back? How far?

Answer 35: This is a judgment call. Character is best demonstrated during periods of economic distress and so looking back at least through a complete business cycle is important. Certainly any material credit problems in the last 2 to 5 years would be very problematic and typically (though not always) result in a reject. Events that occurred prior to that, especially if more than 15 or 20 years would not have as material an impact, but may still be relevant and should be considered in the analysis and credit approval decision.

Question 36: Under Section III.B.4 the borrower must provide a property financial statement that is reviewed by an independent third party Certified Public Accountant (CPA) and includes actual copies of the insurance and property tax bills. What should the borrower provide: a certified financial statement for the property, a compiled financial statement or an audited financial statement for the property? If the financial statements are prepared by a CPA, do we need to require a different CPA to review them? What should the CPA review of the financial statements contain and cover? Who will be reviewing the insurance and property tax bills and what will the review cover? What about the review of YTD (year to date) statements, especially as the year progresses?

Answer 36: If the statements are not audited, a CPA "reviewed" statement is required. "Audited," and "Reviewed," are defined professional standards for reports understood by CPAs. The intent of the requirement is to obtain an independent (non Identity of Interest) professional review of the financial statements certified by the Owner. If the statements are audited by an independent CPA, no further CPA review is needed to validate the statements.

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Question 37: Section III.B.6 requires that a rental lease audit be performed. What type of documentation will we be requesting for proof of the audit?

Answer 37: The Lender must fully investigate and explain any inconsistencies or conflicts between the leases, rent roll, and the underwritten revenue assumptions. The Lender should discuss the scope and results of the review in the Underwriters Narrative. They should maintain a copy of the documents (e.g. copies of individual leases reviewed) in their working papers, which are subject to audit but do not need to be included in the Firm Commitment application submission.

Question 38: Section III.D.2.b, regarding the Lender's assessment and preliminary evaluation for the Borrower's creditworthiness in a pre-application, is unclear. What is required?

Answer 38: Mortgage Credit review is still reserved to the Firm stage, but we want to get at least preliminary information in pre-application, especially for large transactions. Typically a resume, basic organization chart, and summary financial statement of the sponsor would be available and appropriate.

Question 39: Under Section III.D.5 regarding the absorption period, what happens for very large projects with longer absorption, can a waiver be required for projects other than high rise buildings?

Answer 39: Generally, waivers should not be given, but there may be rare exceptions.

Question 40: Section III.D.12 regarding operating deficit reserves states, "The Lender is responsible for insuring funds are released solely for project operating needs." Who releases the funds?

Answer 40: The lender will release the funds with authorization from the field offices in accordance with MAP guidelines.

Question 41: In regard to III.A.4.d, when OFAC searches are done, should the lender include EPCS & LDP? Should the print-out of the searches or a certification that they have been done be included in the application?

Answer 41: A printout is not necessary, just address the issues in the mortgage credit section of the underwriter's narrative. The OFAC check is not required until initial endorsement and is not part of HUD's review.

Question 42: What should be done when the REO schedule differs from the financial statements?

Answer 42: If the differences are material, as opposed to minor variations arising from timing of statements, changes in principal balances, etc. then the lender should investigate, reconcile and explain the differences.

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Question 43: Now that we get a new PCNA every ten years, do we still need to run out a reserve schedule for years beyond ten?

Answer 43: Yes. The MAP Guide requires the schedule be analyzed for the life of the loan. Particular scrutiny should be given to the first 15 years.

Question 44: Please clarify if a syndicator/tax credit investor needs to provide the REO/mortgage debt schedule in LIHTC transaction.

Answer 44: Typically a tax credit syndicator is an investor intermediary with only a limited ongoing obligation to LIHTC rental properties. Accordingly an REO schedule would not need to reflect multiple properties previously syndicated. However, the syndicator's liquidity, track record, asset management and monitoring capability, and ability to perform on its promise to provide equity to the mortgagor is a very material issue for mortgage credit analysis.

Question 45: Under the new Risk Mitigation ML/HN, is it ever appropriate to allow cash out on a 223(f) refinance when there are repairs? What about when there are no repairs needed?

Answer 45: The Section 223(f) Loan Limit in a cash out situation is unchanged at 80%; so long as the transaction is appropriately valued and underwritten, cash out is acceptable and within the program intent. This is true whether or not there are non-critical repairs. The Risk Mitigation ML/HN requires 50% of the cash out be held back and distributed after the non-critical repairs are complete – this requirement refers to the timing of cash out, not whether it's appropriate.

Q&A's issued Previously (in *italics*)

Q&A's issued 7/8/10:

Question 1: *The implementation date of the Mortgagee Letter and Housing Notice is ambiguous. The first paragraph states it "will be effective 60 days from the date of issuance, as discussed below in the section titled "Implementation". The implementation section states (for example) "Changes to the Section 220, 221(d)(4), 221(d)(3), 231 and 241(a) programs will be implemented as follows: i) 60 days after the effective date of the ML" When do the new changes become effective, 60 days, or 120 days after the date of the notice?*

Answer 1: *The implementation date is 60 days after the date of the Mortgagee Letter and Housing Notice dated July 6, 2010, which is September 4, 2010. So COMPLETE Preapplications (or Firm Commitments for refinancing) submitted by close of business Friday, September 3rd, 2010, are "grandfathered". Preapplications (or Firm Commitment applications for refinancing) submitted September 7th (the day after Labor Day) will be subject to the new guidelines.*

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Question 2: *When will the new guidance be effective / implemented for new construction or substantial rehabilitation applications going directly to Firm i.e. that will not need or request a Preapplication submission?*

Answer 2: *Per Section V.iii. of the Notice and Mortgagee Letter, 90 days from the date the Notice/Mortgagee Letter was signed. So such Firm Commitment applications submitted on or after October 4, 2010, would be subject to the new guidelines. After October 4, direct to firm applications for new construction or substantial rehabilitation is only available for affordable transactions (per the Notice/ML definition).*

Questions 3, 4 & 5 are superseded by Question 9

Question 3: *I have a Preapplication submission that HUD is now processing. How long after issuance of the Invitation letter will I have to submit a Firm Commitment application under the previous underwriting standards, 120 days or 90 days or some other period?*

Answer 3: *Up to 120 days, so long as a complete application for Firm Commitment is submitted within that time period. An example: If an Invitation letter was issued July 30, 2010, a complete Firm Commitment application submitted on or before Friday, November 26, 2010, would be accepted. If an extension was needed and the Firm Commitment was submitted on or after Monday, November 29, 2010, the application would need to comply with the new underwriting standards and guidelines.*

Question 4: *I received an Invitation letter from HUD last month, on June 1, 2010. Must I submit my firm commitment within 120 days without extensions to be grandfathered in, or is it 120 days from the date of the publication of the Notice and Mortgagee Letter?*

Answer 4: *120 days from the date of the Invitation letter. So long as a complete application for Firm Commitment can be submitted within the time allowed by the Invitation letter with no extensions, it will be “grandfathered in”. Thus, in this example, so long as the Firm Commitment is submitted on or before close of business Wednesday, September 29, 2010, the application would not be subject to the underwriting changes specified in the Notice and Mortgagee Letter. If an extension is needed, and the Firm application in this example is submitted on or after September 30th, the Mortgagee Letter and Housing Notice provisions would be applicable.*

Question 5: *We received an Invitation letter several months ago, and last month received an extension on the time allowed to submit the firm. That extension expires in August, by which time we will have submitted the Firm Commitment application. Is the Firm Commitment application subject to new rules? If not, can I ask for another extension?*

Answer 5: *The Invitation letter and previously issued extension should be honored, and “grandfathered” in under the previous underwriting standards and guidance, assuming the Firm Commitment is submitted within the time period allowed in the previously approved extension. Any further extensions would be limited by the terms specified in ML 2010-01 (up to 90 day extensions for Invitation letters, 120 days for Firm Commitment extensions) and would be conditioned on applying the new underwriting standards and guidance.*

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Question 6: *On page 8 of the Notice, the last sentence of paragraph C.2., reads “If not subject to a transfer of physical assets and approved by the MF Hub Director, surplus cash notes may be established for payables owed to a related entity only.” The phrase “If not subject to a TPA” is not included in the parallel paragraph in the ML, page 8; please clarify whether this condition is intended to limit the MF Hub Director’s approval authority?*

Answer 6: *While the phrase directly applies to HUD staff’s approval authority, it would have been helpful to include it in the Mortgagee Letter as well as the Notice. For projects subject to a TPA, payables should be cleared at the time of the refinancing/acquisition transaction. Similarly, as noted in the ML and Notice, payables to non-identity of interest entities should be cleared at or prior to closing.*

Question 7: *Page 6, paragraph 7 discusses the site inspection and lease audit requirements. Is the number of lease audits requirement the same as the number of units to be inspected? Should those units inspected be the same as those subject to the lease audit, or different units, or is it in the Lender’s discretion?*

Answer 7: *The number of units is the same. Typically we would anticipate the lender would review the leases on the same units as those inspected, but the lender has discretion in the selection.*

Question 8: *I have a question about applying the new Risk Mitigation Notice/Mortgagee letter to a specific transaction. Who should I contact?*

Answer 8 : *HUD staff should direct questions to Joyce Allen at (202) 402-2471 or Dan Sullivan at (202) 402-6130. Lenders should direct questions (particularly about specific deals) to the local HUD Field Office, or can call Ms. Allen or Mr. Sullivan with general questions.*

Q&A’s issued 7/15/10:

Question 9: *We have a project that received its Invitation to Apply on April 5 and has been working diligently on Section 106 Historic compliance because there has been extensive community and professional consultation. 120 days from April 5 is August 3. Is it possible to get a 30-day extension, to complete the plans and submit the Firm Application without triggering the new underwriting standards?*

Answer 9: *Yes. ML 2010-21, Paragraph V. (ii); “Implementation” states “up to 120 days [after the effective date of this ML] for projects with outstanding invitation letters, or such shorter time as the invitation letter provides, so long as a complete application for Firm Commitment can be submitted within the time allowed by the invitation with no extensions.” 120 days (4 months) from the date the ML was published is November 3, 2010. This means “outstanding invitation letters” are still under outstanding MAP Guidance and thus are eligible for up to three 30-day extensions, or per Notice 2010-01 one 90-day extension. Thus, so long as a Firm Commitment application was submitted within the allowed extension period under the MAP Guide or ML 2010-01, the application would not be subject to the new Risk Mitigation Housing Notice and Mortgagee Letter. Please note, this Question and Answer supersedes Q&A #4 and #5, which have been deleted.*

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Question 10: *The Housing Notice and Mortgagee Letter require a schedule of Real Estate Owned (REO) for principals, and a schedule of maturing debt against that Real Estate. Is there a specific template required? Does the schedule of debt need to include loans for every asset on the REO schedule?*

Answer 10: *The Lender can use whatever format they wish so long as it contains the information on the attached spreadsheet and any other sufficient information to present their underwriting analysis and conclusions. A sample is attached, which should be accompanied by the Lender's analysis and conclusions as to the Mortgagor's and Principals' creditworthiness. The debt schedule should include loans that are maturing, or if floating rate debt have resets, within the next 5 years. Other debt that has a material impact on the Principals' creditworthiness should be included as well (e.g. if they are in default or are likely to have problems with a loan over the next few years.)*

Q&A's issued 7/27/10

Question 11: *Application will not be ready to submit a Pre-app by Sept 4, 2010; would they be able to receive a 30 day waiver on the time for filling the pre-app beyond the Sept date?*

Answer 11: *No*

Question 12: *Does the REO schedule disclosing a principal's real estate portfolio have to disclose all properties in which they have any interest, or only those where they own more than 25% or are the managing member/general partner?*

Answer 12: *Only where they are a "principal" per the Previous Participation definition (which also includes officers of corporations and stockholders with 10% or greater interest.). Also, the underwriter needs to analyze and disclose to HUD as part of their recommendation any interests that don't rise to that level, but nevertheless have a material impact on the creditworthiness of the proposed mortgagor or its principals—this is a judgment call, and typically won't be an issue, but from time to time will come up.*

Q&A's issued 8/23/10:

Question 13: *Definition of Affordable Housing Section III.A.1 – Does 1.a. intend to say that affordable is defined as either "(a) + (b)", or "(c)"? "(a)" alone only requires a 15-year regulatory agreement (which would be the case with any HUD-insured loan), and "(b)" gives the rent restrictions.*

Answer 13: *Affordable definition incorporates both (a) plus (b). Paragraph (c) emphasizes that an "affordable project" does not need to have actual LIHTCs so long as a recorded regulatory agreement is in place for the term specified, and meets or exceeds the rent and income standards for the LIHTC program.*

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Question 14: *Section III.A.4 - Principals for purposes of Mortgage Credit Analysis are defined in II.A.4.a as those parties who are subject to APPS/2530 review. If a tax credit investor partner is determined to be an LLCI exempt from the APPS/2530 review, are they also exempt from the Lender's mortgage credit review? It would be a monumental task to obtain and review the new schedules for REO and Debt for most tax credit partners, but it would be prudent to perform the mortgage credit review previously required by MAP.*

Answer 14: *We agree that a mortgage credit review of the principals of the tax credit investor is required. More details about the specific organizational structure would be needed to answer the question. HUD will be addressing this topic in forthcoming training.*

Question 15: *Section III.B.3 – 223(f) Release of Cash / Equity: Will there be a new escrow agreement to govern the 50% hold back, or will the Repair Escrow Agreement or some other document be modified to cover this?*

Answer 15: *The Lender has discretion as to the form of the escrow used to hold back the 50 percent net proceeds. Those proceeds may not be released until non-critical repairs and improvement work is completed and HUD approves the release. The Lender's file should contain the HUD approval and documentation supporting the release.*

Question 16: *Section III.B.6 – This requires an Underwriter Site Inspection for 223(f) properties but there is no similar requirement for sub rehab. LQMD has interpreted 5.16 of the MAP Guide to require that the Lender (in addition to the Lender's Architectural Reviewer) participate in the Joint Inspection. Will that interpretation be enforced? If so, III.D of this ML should be amended to require an Underwriter's site inspection for sub rehab.*

Answer 16: *Section III.B is entitled "Program Changes – Section 223(f) Program Underwriting Guidelines" and Section III.B.6 provides site inspection and lease audit requirements for the approved MAP underwriter under the Section 223(f) program. MAP guidance under the existing Section 5.16 for joint inspection of substantial rehabilitation proposals is unchanged and remains outstanding.*

Question 17: *Section III.C.1 – This says that 223(a)(7) "may" be processed under MAP. Is this optional or does IV.D make MAP processing required? Does processing under MAP mean that an environmental assessment will now be required, or an appraisal, or an Underwriting Summary? Or, are the items listed in this ML the only changes that will occur when a 223(a)(7) transaction is processed under MAP?*

Answer 17: *The provision is intended to establish time frames for Section 223(a)(7) and make it clear that Section 223(a)(7) is not a lower priority than other MAP deals. Except as specified in the Notice and Mortgagee Letter all other outstanding program guidance is unchanged.*

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Question 18: *Section III.D.7 – (NC/SR) Cash out from Land Equity: A final draw of loan proceeds has to occur at final endorsement. Will the land equity remaining at final endorsement then go into an escrow account and, if so, will a new escrow agreement be created or an existing one utilized for this?*

Answer 18: *Similar to answer provided for #15 above, the Lender has the discretion as to the form of the escrow used to hold back any cash out from land equity above what is needed at initial endorsement. HUD approval of release of those proceeds will be granted when the project is complete and has achieved 6 months breakeven occupancy. The Lender's file should contain the HUD approval and documentation supporting the release.*

Question 19: *Section III.D.8.c – (NC/SR): Who is to determine that there are “no questions” regarding the contractor’s performance, compliance, etc. so that retainage can be released at the new prescribed schedule? Is it a Lender call or does the local HUD office need to be consulted as well?*

Answer 19: *The MF Hub or Program Center Director makes the decision based on the recommendation of HUD’s construction inspector.*

Question 20: *Section III.D.9 – (NC/SR): Can any excess funds that remain in the Contingency line item be applied to the Replacement Reserve in order to help preserve the original loan amount?*

Answer 20: *The lender has discretion subject to the HUD field office approval.*

Question 21: *Section III.D.13 – (NC/SR): Will the Mortgagee’s Certificate be modified to show the new terms of the Working Capital escrow or will a new Working Capital escrow agreement be created?*

Answer 21: *This question and answer remain under consideration.*

Question 22: *Section IV.D – Will TAP processing still be allowed in cases where the Lender has an identity of interest that prohibits MAP processing?*

Answer 22: *Yes.*

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Question 23: *Specific Timing Case #1* I have one Invitation Letter that was issued in August. Since there is no possible way to submit a Firm Commitment within the 120-days, the new guidelines will allow us to request an extension, but we have to tell our Sponsor that we are required to change up the previous underwriting of the loan after HUD has invited the Application? Is there any option to receive an extension under the old guidelines on a case-by-case basis?

Answer 23: Yes. See the Q/A #9 published 7/15/10 which supersedes Q/A's 3, 4 and 5.

Question 24: *Specific Timing Case #2* I have another Invitation Letter that was issued on March 10, 2010 and the 120-days expired on July 10, 2010 (four days after the new Mortgagee Letter was issued). The Sponsor has proceeded in good-faith on his Firm Application exhibits spending several \$100,000 in the process on his plans, specs, etc... As previously required, we had requested a 90-extension according to Mortgagee Letter 2010-01 and even spent additional money for a Market Study Update to prove that the market has not changed since the invitation. According to the Q&A, it appears that an extension is not available to "grandfather" him under the original underwriting guidelines? Do we have to tell him that HUD has changed their program at the last minute and he has to now come up with \$500,000 of additional equity at the 11th hour? Can this extension be approved on a case-by-case basis? By the HUB Director?

Answer 24: See the Q/A #9 published 7/15/10 which supersedes Q/A's 3, 4 and 5.

Question 25: Is there a new debt service coverage ratio (DSCR) and loan ratio (LR) for 221(d)(3) market rate projects? The table attached to the Housing Notice lists "no change" for 221(d)(3) with 90% or greater rental assistance, but the Mortgagee Letter doesn't reference 221(d)(3) in that line at all.

Answer 25: For 221(d)(3) with 90% or greater rental assistance, no change. Other 221(d)(3)'s are assumed to be "affordable", and the 1.11 debt service coverage and 95% loan to cost ratios would apply.

Question 26: I am still unclear as to whether extensions can be granted on Invitation Letters and still have the old rules apply. For example, if we submit a complete pre-application package to the local office on September 1, 2010 (prior to the 60 days mandated in the ML) and the local office issues an Invitation Letter on October 31, 2010, it is understood that we would have 120 days (February 28, 2011) to file the firm application under the old rules. Would we have the opportunity to request a 90-day extension (May 29, 2011) and still have the old rules apply? #3 and #9 of the Q&A's seem to contradict one another. Perhaps the distinction trying to be made is with respect to Invitation Letters that had been issued prior to the issuance of the ML on July 6, 2010. Please clarify.

Answer 26: See the Q/A #9 published 7/15/10 which supersedes Q/A's 3, 4 and 5.

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Question 27: *The ML indicates that "the MAP Underwriter must perform an on-site lease audit and physical inspection representing a sample of each unit type". The next sentence goes on to say that an analyst, underwriter trainee, or MAP approved underwriter acting under the direction of the underwriter (i.e. one that does not report to the originator) may perform the site visit and physical inspection of the units. My question is as follows: Can an analyst, underwriter trainee, or a MAP approved underwriter (not necessarily the MAP approved underwriter for that particular transaction) perform the site visit, the physical inspection of the units, and the lease audit?*

Answer 27: *Yes. Generally we expect the MAP approved underwriter to perform the site inspection and lease audit. The Notice and Mortgagee Letter allow for other qualified individuals under the direction of the MAP approved underwriter to perform the inspection and lease audit. This should be specifically addressed in the lenders underwriter narrative and certification.*

Question 28: *Please clarify the definition of "transaction costs" in Section B.3, which discusses the 50% hold back for cash-out transactions. Are these mortgageable costs or all costs including other escrows for taxes and insurance, etc.?*

Answer 28: *The transaction costs are those which are mortgageable costs.*

Question 29: *With regard to the escrows on construction loans, I see that the servicer is given more responsibility regarding operating deficit withdrawals. I think we need additional guidance regarding the administration of the working capital escrow. It seems as if HUD is trying to make this a second operating deficit escrow because it can't be released until the project has achieved 6 months of break-even activity. Often this escrow is used up by project completion. Is HUD indicating we shouldn't let that happen? Or, should we use it to fund the permanent escrows at final endorsement?*

Answer 29: *This question and answer remain under consideration.*